

# **Chapter-1**

## **INTRODUCTION**

### **1.1 Background of the Study**

Nepal is a developing country. It has many opportunities to invest but there is no any strong source of revenue. In Nepal, formal-financial system began in 1973 with the establishment of Nepal Bank Limited (NBL), which is the first commercial bank of country. The economic development of country depends upon the strategy implemented by the government and participation of private sectors. In the recent year, people in Nepal have poured funds in newly established companies in the country encouragingly. However, there is no satisfactory growth of such business enterprises until 1990. Nepal government, under a program initiated to reform capital markets, converted securities exchange center into Nepal stock exchange in 1993, which brought new atmosphere in the Nepalese capital market. Nepal stock exchange (NEPSE) is a non-profit organization, operating under securities exchange act 1983. The basic objectives of NEPSE is to import free marketability and liquidity to the government and corporate securities by facilitating transaction in its trading floor through market intermediaries such as brokers.

Financial institutions are the lifeblood of the economy, without these, the operation of an economy cannot be succeeded. Even the rapid development and expansion of financial institution, the country has not been able to achieve the desired income so for which is due to poor capital market condition in the country. Thus the financial institutions play a vital role in the (economic development) capital formation and proper utilization of fund, providing service in domestic and international trade. The development of systematic market of security is regarded as the securities issues by every government in the country. Due to lack of

secondary market of government securities in Nepal, Nepal Rastra Bank (NRB) has been actively issuing various government securities in the country. The bank was established in 1956 under the Nepal Rastra Bank Act 1955. The new Nepal Rastra Bank Act was brought out in 2002 by replacing the erstwhile Act of 1955. As the country's central bank, this bank has the sole right to issue currency notes, coins and is responsible to manage the country's foreign exchange reserves. The bank also renders advices to the government on financial and economic matters. The banks also manage public debt. In the late 1980" liberalization of interest rate, creation of regularities framework that includes prudential regulations on capital adequacy, and the establishment of separate supervision department at the Nepal Rastra Bank, were also undertaken. Therefore, the bank issues various governments securities to recoup deficit budgetary system of Nepal.

Government sells various securities in the market. Treasury Bills, Development Bonds, National Saving Bonds, Special Bonds and Citizen Saving certificates are known as government securities. The securities which are sold by government to collect the fund are called government securities. Government securities are issued to raise capital in the market. Government Issue securities internally and externally. The main source of internal debt is government bonds. Government takes loan from its own people as well as financial institutions to fulfill the budgetary deficit and others purpose, this type of is called internal debt. Government bond is one of the most important issuance of the government to maintain the deficit budgetary system of Nepal. It has been suffering a lot since the first budget 1951 in Nepal. The increasing trend of deficit budget has been balanced by borrowing from public. Government bond is a part of public debt. Some studies related to public debt by the master level student from economic faculty are available in the T.U. library. Many economists have defined public debt as per their

own view. Public debt refers to loan raised by a government with in the country or outside the country.

According to the Bastable "Public finance deals with the expenditure and income of the public authorities of the state and their mutual relation as also with the financial administration control. (*Thakur, 2005:168*). Every state first determine its expenditure from its different income sources such as collection of tax selling government securities etc. According to the J.K. Mehata "Public finance constitutes a study of monetary and credit resources of the sate" (*Sharma, 2005 : 37*).

There are two majors sources of public borrowing, external and internal sources. Internally government can borrow from individual financial institution, non-banking financial institutions, commercial bank and central banks. Similarly, the main sources of external borrowing are firstly international financial institution like IMF, World Bank, IPA and ADB etc. This institution gives loan to the member countries for a short term for convening the temporary balance of payment difficulties and for a long term development project. Secondly, the countries of good relations also provide the loan for development projects. (*MoF, 2062-063*).

The government of any country is liable for running the development activities, necessary activities, maintaining law and order in the country, working for interest for helpless and poor people arranging for health, education, road drinking water etc. The regular revenue of developing countries are not adequate to provide all afore said services to people. Thus, the government has to raise the necessary funds through the tax and non tax revenue as well as public borrowing. Since, the government borrows the funds with its total liability; it is also called government debt.

The developing country like Nepal is facing the main challenge of inadequacy of capital for the investment in development activities. Due to this reason government issues various securities in the country. The collected funds are spent on development function for the welfare of people. Government commences various projects in the county. These are not for getting benefit but for the welfare of the people. Therefore, it is believed by all that government works in the country on behalf of people for it has high responsibility to develop country.

The government securities play an important role in the economic development of the country. It is very difficult to get uniform definition of government securities. The most important aim of the government securities are to raised the fund to government to fill the gap between the revenue and expenditure. Government bond is regard as the temporary sources of financing for various government functions. For instance, hospital, schools, university, bridge, roads, water supply project, irrigation project etc. These functions are required for the economic development of the country. Government needs funds to maintain peace and law and order in the country. Therefore, issue of government bond in such situation is the main source for raising funds internally. Internal debt is the most absolutely essential tool of financial management. "In fighting depression, the money remains unutilized due to the lack of entrepreneurship. Nobody is ready to invest their funds, as there is less profit or very low expectation. At such as stage government can utilize this money by raising loans and increasing the public expenditure. On public works in the country, government may borrow from the banks and release the funds for supplementing the private enterprise". (*Lekhi, 1995*).

Government collects the revenues in terms of tax in order to meet expenses like war, maintenance of law, general administration, government expenditure, defect budget etc. But in Nepal, most of the

people lie under the poverty line. So they are unable to pay taxes. In others words, the earning of the most people is below the taxable income. 2<sup>nd</sup> source of revenue collection is subsidies and internal debt. It is said that basically, Nepal depends upon the foreign aid for required capital imports. But the subsidies are not strong sources, because it depends upon the vision, attitude, capacity and external of donor. External debt also isn't an easy way to get sufficient funds. External debt is very costly loan because it has to repay to the foreigners in term of gold, silver or some others hard currency acceptable to them. Third source of revenue collection is internal debt. Beside it, internal debt is collected for other purpose also. Such as it is used to create infrastructure, it is used to increase productivity, it is used to generate wealth for critical situation.

## **1.2 Concept of Financial Market**

Financial market refers to the place where the transaction of both short term and long term financial instruments between buyers and sellers takes place. In another word, it is the place where a person can invest his saving in different market instruments having different level of risk and return. Similarly, it is the source of accumulation of fund, which is needed by the business enterprises as well as government for their establishment, expansion and day-to-day operation. So, financial market is both investment region for the investor and financing region for the government and Business Corporation. It is the trading zone, which is composed of both money and capital market.

Financial market has been the area of performance of several stakeholders. The major influential stakeholders of financial market are banks, finance companies, insurance companies, stock market, investment banker, government etc. One party's shortage of the capital can be fulfilled through the surplus capital of another party in the well-developed financial market. With the establishment of well-developed

financial market in a country, huge business venture can be established by generating the fund with the short term or long term market instruments. The development of financial market is very important for the development of the economy of a country. To make the investing and financing activities smooth and attractive, sound financial market is the most important component. As the developing nation like Nepal is attempting to attract foreign investment, well-developed financial market is the necessary condition for them to operate. So, financial market is the back bone of the industrial development of a country, which in fact is the pivot of the economic development.

The development of financial market needs the great contribution from the side of government. Market based economy; financial reforms and market deregulation are the some key factors, which is essential for the development of sound financial market in a country. Government policies should be favorable for the market-based economy for the creation of efficient financial market. In Nepalese context, though the government has taken some measures such as liberalization of economy, adoption of open economy etc, the financial market is still in underdeveloped stage. The capital market is not functioning as per desire due to lack of expertise of the major stakeholder of the capital market, lack of knowledge to the investor about it, low credibility in the securities investment etc.

### **1.3 Financial Market in Nepal**

The history of financial market in Nepal dates back to the era of Rana Prime Minister Juddha Samsher when Gunjaman Singh, the first secretary at the Nepalese Embassy in England Returned back to the Kathmandu and set up the 'Industrial Council." The council drafted the company act and Nepal bank act for the first time in 1992 B.S. The first public floatation of shares in the securities market was initiated by

Biratnagar jute Mills Ltd. in 1993 B.S. There were very few companies in Nepal issuing shares to the general public until another company act came into operation in 2007 B.S. Many industries including Jute, Sugar, Match, Textile, Chemical and furniture were established in Nepal and disappeared because of many reasons. For many years after 2006 B.S., Nepal passed through a trauma of series of political instability. During the Panchayat Regime (2017-2046), the economy was based on central planning and most of the industries were opened in the public sector. Various control measures were adopted providing with difficult rules and regulations required registering companies and thus private sectors was eventually discouraged. There were only two Financial Institutions, Nepal Industrial Development Corporation and Agriculture Development Bank, in existence to finance industrial and agricultural projects along with the two domestic commercial banks. The government approach during this period was to expand banking services to remote villages of nation in order to encourage agriculture production, small scale industries and service sector in the economy. Corporate industries involving huge capital investment were opened in the public sector. No industrial environment was created in the country to set up corporate undertaking in the private sector.

The non-security market of Nepal came under regulatory framework when Nepal Rastra Bank established in 2012 B.S. prior to this, Nepal bank Ltd. was the only financial institution operating under Nepal Bank Ltd. Act 1993 B.S. Another commercial bank, Rastriya Banijya Bank was established under Rastriya banijya Bank Act 2022 B.S. in the public sector. A single commercial act was enacted in 2030 B.S. to consolidate the functioning of all the commercial banks under one legal umbrella. Also finance companies act and development bank act came in 2041 B.S. and 2052 B.S. respectively. At present the country has 23 commercial banks including Joint venture Banks, 35 Development Banks including

Agriculture developments Bank and Nepal Industrial Development Corporation and 60 finance companies operating in financial market. Besides there are 17 insurance companies including deposit and credit guarantee corporation and other non depository institutions like Employees Provident Fund and Citizen Investment Trust collecting huge amounts of fund from the public in different forms and nature providing long term funds to the people for various purposes.

In this way, institutional development of securities market in Nepal started from the year 2033 B.S. when securities exchange center was established under the company act with the joint capital contribution of Nepal Rastra Bank and Nepal Industrial Development Corporation. The industrial policy of the government also encouraged the promotion of securities activities in Nepal.

#### **1.4 Concept of Security Market**

The securities market is known as the market where all types of securities are traded. Security market is a broad term embracing a number of markets in which securities are bought and sold. Securities market includes how an individual investor goes about the business of placing any order to buy or sell, how the order is executed, the process of setting the payment and transfer costs and one hopes the payment of federal personal income taxes on the profits from the transaction. These securities include equity shares, preference shares and debentures.

The securities market may also be divided into two parts:

##### **a) Primary Market**

In the primary market the original issuance of the financial instruments of a company is traded. The company should sell its approved share through the authorized issue and sales agent. The company has to register its shares in the SEBO to get the valid authority to the issuance



of the shares. Primary markets provide an important allocate function by channeling the funds to those who can make the best use of them presumably, the most productive.

#### **b) Secondary market**

In the secondary market the share once issued in the primary market are traded. So, the secondary market liquidates the share and provides the opportunity between the investor and the seller of the securities. The company must list the securities in the security market for the transaction purpose.

In the secondary market existing securities are traded and thus enabling disposal of these securities whenever the owners wish. An active secondary market is therefore a necessary condition for an effective primary market, as no investor wants to feel 'looked in' to an investment.

#### **1.4.1 Historical Background of Security Market in Nepal**

The history of capital market in Nepal dates back to 1936 in which year the shares of Biratnagar Jute Mills Ltd. were floated. In 1937, Tejarath was set up to facilitate loans to the government employees and was converted into Nepal Bank Ltd. HMG Nepal introduced the Company Act in 1964 and the first issue of government bonds made in the same year through Nepal Rastra Bank to collect the developmental expenditures. It carried 6 percent rate of interest and had the maturity period of five years (Shrestha 2038). HMG Nepal announced the Industrial Policy in 1974 and under this policy an institution named Securities Marketing Center (SMC) was established to deal in government securities-development bonds and national savings bonds, and corporate securities of few companies. The government has the virtual monopoly over the security market. Then, Securities Exchange Center (SEC) was established in 1976 with an objective of facilitating and promoting the

growth of capital market. It was the only capital market institution in Nepal. Securities Exchange Act came into force in 1984. Since then, SEC started to operate under this act. The purpose of this act was to provide systematic and favorable market environment for securities ensuring and protecting the interest of individuals and institutional investors as well as to increase the public participation in various firms and companies (Gurung 1999). SEC had provided facilities to trade the government securities and few of corporate securities like shares and debentures. Only the shares of 10 companies were listed in SEC and there was involvement of no broker and dealer in the securities market. So, SEC itself was undertaking the job of brokering, underwriting, managing public issue, market making for government bonds and other financial services (NEPSE 1998). Apart from this, there was the absence of effective secondary market to ensure liquidity to the securities. The interim government (1990/91) initiated financial reform program and two indirect investment vehicles-Citizen's Investment Fund and NIDC Capital Markets Ltd.-were established with the collective investment schemes in the corporate sector (Gurung 1999). Then, due to the world whim of privatization and economic liberalization, the operation of SEC was felt to change to make it compatible with the changing economic system. As a result, HMG Nepal brought about change in the structure of SEC by dividing it into two distinct entities-Securities Board, Nepal (SEBO/N) and Nepal Stock Exchange Ltd. (NEPSE) at the policy level in 1993. Since then they are operating as the main constituents of securities market in Nepal. SEBO/N was established on June 7, 1993 with its mission to facilitate the orderly development of a dynamic and competitive capital market and maintain its credibility, fairness, efficiency, transparency and responsiveness under the Securities Exchange Act 1983 (SEBO, 2001). It is an apex regulator of the securities market in Nepal. It registers the securities and approves the public issues. Moreover, SEBO frames the policies and programs required to monitor the securities market,

provides license to operate stock exchange business and stock brokers and supervises and monitors the stock exchange operations and securities businesspersons. NEPSE Ltd. is a non-profit organization, operating under Securities Exchange Act, 1983. The basic objective of NEPSE is to impart free marketability and liquidity to the government and corporate securities by facilitating transactions in its trading floor through market intermediaries such as brokers and market makers, etc. NEPSE opened its trading floor on January 13, 1994 through its newly appointed licensed members and has adopted an "Open Out-Cry" system for the transaction of securities. The trading floor is restricted to listed corporate securities and government bonds with the market intermediaries in buying and selling of such securities.

#### **1.4.2 Meaning of Government Security**

Government sells various securities in the market. Treasury Bills, Development Bonds, National Saving Bonds, Special Bonds and Citizen Saving certificates are known as government securities. The securities which are sold by government to collect the fund are called government securities. Government securities are issued to raise capital in the market. Government Issue securities internally and externally. The main source of internal debt is government bonds. Government takes loan from its own people as well as financial institutions to fulfill the budgetary deficit and others purpose, this type of is called internal debt. Government bond is one of the most important issuance of the government to maintain the deficit budgetary system of Nepal. It has been suffering a lot since the first budget 1951 in Nepal. The increasing trend of deficit budget has been balanced by borrowing from public. Government bond is a part of public debt. Some studies related to public debt by the master level student from economic faculty are available in the T.U. library. Many economists have defined public debt as per their

own view. Public debt refers to loan raised by a government with in the country or outside the country.

### **1.4.3 Types of Government Security**

In Nepal, a gap is always arising between revenue and expenditure of the government. By this cause, the nation has to face with deficit. To tackle the deficit budget of Nepal, Government has been issuing various securities to collect the funds from public. Many analysist and author agreed to collect the funds from internal debt, which is not so risky as compared with external debt. According to them the money just transfers from one person or institution to another institution. In facts circulates within the country. So the proper utilization of internal debt promotes the economy of the country. Government issues long-term and short-term bonds depend upon the investment for such bonds. The amount to be raised from internal debt is planned at the time of budget declaration. Thus, the types of internal debt in Nepal are classified on the following headings.

- A. On the basis of nature
- B. On the basis of name
- C. On the basis of period

#### **A. On The Basis of Nature**

**(i) Promissory Note:** A promissory note is also known as liquid notes because it can be exchange easily and the ownership can be transferred by simply endorsement. It is not necessary to go NRB to transfer the ownership of this note. In other words, the note whose ownership can be transferred by endorsement is known as promissory note. This note can't be transferred particularly. It should be transferred in full amount. In first issue, the promissory note is issued for individual only but the ownership will be transferred to institution by the domestic endorsement, if the ownership will be transferred to institution by the domestic

endorsement, the promissory note should be changed into stock by giving a notice to NRB.

**(ii) Stock:** Stock is also known as the secured security because the ownership of this bond can't be transferred by endorsement. To transfer the ownership of stock, the owner of the stock should be registered on application in NRB under dwelling the rule of NRB. The ownership of stock can be transferred with full amount as well as partially, Institution can purchase only the stock as long-term bond but the individual can purchase both promissory note and stock.

### **B. On The Basis of Name**

**(i) Prize bond:** Whole or partial amount from the interest amount is given as the prize from lottery system is known a prize bond. Interest is not given in this bond. In this bond, the lottery may be gained before the maturity period of bond and it is only the most attraction of this bond. The principle will be repaid after the certain period. Prize bond was issued by Nepal Government in fiscal year 1967 through NRB.

**(ii) Bearer Bond:** In this bond, which brings the certificate, he can get the payment. The interest rate is fixed in this bond. The "bearer" word is included in the bond; the certificate holder of bond will have the right to get the payment without any formality.

**(iii) Treasury Bill:** It is a short-term government bonds to uphold deficit budgetary system, it also known as the barn bond. Normally, treasury bills mature in 91 days while some matures in 184 days and 364 days also. It is issued on the basis of auction, so that any individuals and institutions can invest in treasury bills. The treasury bills have been issuing since 1961 in beginning. The Treasury bill was issued by fixing the certain interest rate or by adopting the tap issue system. In Mangsir10, 2045 B.S. treasury bills were issued on discount basis. Today, we see discounted interest rate Treasury bill in the market.

Generally, treasury bills is raised from banking sectors, however, individual also can purchased the Treasury bill. Treasury bill can't be purchased less than Rs. 25000. The maturity period of treasury bills was different in the past. They were issued on the monthly basis. Today, Government has been issuing Treasury bills in weekly basis. Every week, the auction is opened on Monday and the distribution is made on Tuesday. The face value of Treasury bill is refunded to the holder after its fixed maturity period. The subscription of Treasury bills is high in the market since the inception of its first issuance till now. The investors of Treasury bills have to calculate the discount rate percentage as it is issued on discount basis. The following examples can be taken to calculate the discount rate in percentage.

**Example of discount rate in percentage:**

A Person invests in Rs 96 in the Treasury bills today to get Rs. 100 after 91 days. The discount rate in percentage is calculated as

$$\text{Discount rate in percentage} = \frac{(100 - BP) \times \text{days in a year} \times 100}{BP \times T}$$

Where,

BP = Bid Price or Purchase price of Treasury bills

t= Maturity Period of Treasury Bills days in a year = 364 days (364 days are taken in a year to calculate the discount percentage)

**We have,**

$$\begin{aligned} \text{Discount Rate in percentage} &= \frac{(100 - 96) \times 364 \text{days} \times 100}{96 \times 91} \\ &= 16.67\% \end{aligned}$$

$$\text{Bid Price} = \frac{364 \times 100}{364 + (16.47 \times 91)}$$

= Rs. 96

Thus treasury bills are issued to meet short -term financial requirement of the government. It is issued on discount basis. The government has

been collecting huge amount of fund through sale of treasury bills every years to fulfill the deficit budgetary system in Nepal.

**(iv) Development Bonds:**

The bond that is issued to raise the fund from individual and institution for development purpose of nation for long-term is known as development bonds. It has normally 5 years maturity period. It is started to rise in Nepal since fiscal year 1963. It can be used as collateral when taking loans. The holders normally obtained 90% amount of total value. If he keeps them on collateral, it has also fixed and minimum interest percentage, the interest amount will be paid in semiannual basis. The income from this bond is taxable. It is seemed that institutions purchase the maximum share of development bonds. NRB has been issuing these bonds in the market on behalf of the government.

**(v) National Saving Bond:**

It is long-term government bond normally issued for 5 years maturity period. National saving bond can be purchased by non banking sector only like individuals, organizations etc. If the purchaser is institution, it can be purchased in the form of stock and if the purchaser is an individual, it can be purchased in the form of stock as well as in the form of promissory notes. Generally, development bond and national saving bond carries the same nature. It has fixed interest rate and can be transferred from one person to another. It has also semiannual interest payment. The holder gets principle after certain maturity period. These bonds are normally tax free bonds and have high interest rate. Thus taxable bonds have lower subscription than other nontaxable bonds. So National Saving Bond can be sold easily in the market.

**(vi) Citizen Saving Certificate:**

Citizen Saving certificate is also long-term bond. Its maturity period is normally 5 years. The natures are same as other long-term bonds like development bond, national saving bonds etc. Citizen saving certificates can not be used as collateral. If the holders needs fund immediately, the

holder of national saving bond and development bond can be used as collateral to these bonds. The citizen saving certificate can be purchased by individual as well as institutional buyers. It is non-tax free bonds. The interest amount is paid semiannual basis.

**(vii) Special Bond:**

Special bond is issued for special occasion by indicating for special sector by government. Generally special bond is issued if there will be the scarcity of money on the government account and government has to pay the overdraft interest, commission, cash subsidy etc. The interest rate has been fix in the special bonds. Special bond is issued only for institution. The holder of this bond can use it as collateral. Mostly, the owners of this bond are NRB and commercial banks. However some non banking financial institution are also been the owners of this bond.

**(viii) NRB Bond:**

Treasury bill is issued to fulfill the budget deficit however; the treasury can't be issued more than the deadline of the fiscal year (F.Y.) budget. This is the main limitation of the Treasury bill. So, to control the monetary liquidity of the economy, NRB had been issuing the NRB bond as central bank bill since 1991. The liability of this bond lies on NRB, not the government. So, it is not considered as the government bond and it is not included among the financial accessory of internal debt (Id). NRB Bond was issued according to the liquidity position of market. Generally it was also issued for 91 days and it was also gained the legal validity as Treasury bill. The fund had raised through NRB bond by adopting the auction system as treasury bill. NRB bond has been closed to issue since F.Y. 1996.

**C. On The Basis of Time:**

The bonds are also classified on the basis of time. The bonds are divided into two categories under this criterion. One is short-term bond and other is long term bond. Short-term bonds are the accessories of money



market and long-term bonds as the accessories of capital market. Generally short-term bonds are defined as the period that is equal to or less than one year and long-term is defined as the period that is more than one year. So, the economic activity that is done under short-term is said as money market. The repayment period of short-term bond will be equal to or less than one year and that of the long-term securities will be more than one year. Stock market, share market, long term security market are the form of capital market and the local currency market, deposit market, short term security marker are the form of money market. Same financial institution can be worked in capital market as well as money market. The Treasury bill and NRB bond are the short-term securities and rests are the long term securities out of above description.

In case of development countries like United States, Government issues various types of securities to raise capital. They are classified on the following headings.

**a) U.S. Treasury Bills:**

These are short-term securities backed by the 'full faith and credit' of the U.S. government. Treasury Bills or T-bills are issued at a discount and pay interest at maturity. They are normally auctioned in 3, 6 and 12 month maturities. They are federally taxable but exempt from local/state taxes.

**b) U.S. Treasury Notes and Bonds:**

These are intermediate to long-term securities, which carry a stated rate of interest, payable semiannually. They are backed by the 'full faith and credit' of the U.S. government. They are auctioned in 2, 3,5,10 and 30 year maturities. They are also federally taxable but exempt from state/local taxes.

**c) Zero Coupon Bonds:**

They are created from government and agency securities. They are offered at deep discount and pay no periodic interest but interest compounds at a stated rate. These bonds are growing to full value at maturity. They have long maturity period, for instance, up to 40 years. The accreted interest is federally taxable each year as ordinary income but exempt but exempt from state/local taxes.

**d) Mortgage Backed Securities**

These securities represent ownership interest in a pool of mortgage loans. Mortgage Backed securities (MBS) make monthly payments of interest and principal, and have estimated maturity and payment characteristics. The credit quality is similar to that payment of principal and interest. They are estimated 5-30 year maturities but average estimated life is 3-12 year maturities.

**e) Collateralized Mortgages Obligations**

They are typically collateralized by MBS pools designed to provide a wider range of maturities and payment features. These are consisted monthly payments of principal and interest. These are fully taxable securities.

**f) Assets Backed Securities**

These are structured to provide monthly income and high quality. They are generally rated AAA and issued with an intermediate maturity that is more certain than of Mortgagee Backed Securities and Collateralized Mortgage Obligations. These are primary backed by major bank or store credit card receivable and the principal is scheduled to be repaid in one lump sum at maturity. These are expected 3 to 7 year maturities. These are also fully taxable.

**g) Federal Agency Securities**

These are issued by government-sponsored enterprises, with credit quality second only to Treasury Securities. They are available as discounted securities or coupon bearing instruments, which pay interest

semi-annually. These are also federally taxable and from local/state taxes.

In Nepal, Government collects the needed funds by issuing Treasury Bonds Government issues bonds after scheduling fixed face value, maturity period, yields, etc. Government of Nepal started issuing bonds in 1964. This issuance is continuing till today and occupies a chunk of trading in the security market. Government issues are to meet the financial deficit, which is growing every year.

### **1.5 Statement of Problem**

The total expenditures of Nepal Government have increased rapidly in the development process but the total revenue has not increased in the same pace. It is creating resource gap between expenditure and revenue. Ever increasing the resource gap creates an ever growing budgetary deficit. To meet the budgetary deficit government has been resorting to internal borrowing. The fund raised through internal borrowing is growing in absolute amount. But in relative term, it is very small portion of the total deficit. The major portion of the deficit is being met from foreign loan and grants.

It is found that a number of research works regarding public debt has been conducted by many students from economic faculty of T.U. So, the author of this thesis has carefully studies their research works related to public debt. Nowadays, it is seen that the public interest has been increasing rapidly in investing public limited companies as well as government securities. More ever, a large number of investor is interested in investing in secure and profitable sectors. They selected profitable investment sectors among various investment alternatives. Investors evaluate the growth and prosperity of their investment for future. This

help to accomplish their expected return from their investments. Thus it is necessary in these connections, a study on government security system and practices in Nepal due to its systematic market.

In each fiscal year, both internal and external debts have been increasing rapidly. The external debt is increasing more rapidly than internal debt but servicing capacity of the country is not increasing with the same pace. So, our country Nepal is more heavily indebted from external debt than internal debt. This study is related to internal government borrowing. The government issues have higher marketability because it does not have liquidity risk. There are two main sources of government income: taxation and borrowing. Taxation constitutes a method of forced saving and public borrowing is a device to utilize a substantial part of voluntary saving for financing, the development plan of public sector. Public borrowing as a method of resource mobilization has certain advantages over taxation. When a government increases taxes, the tax payers may not be ready to pay tax. The government has to follow optimum tax policy. So the study of public borrowing is essential to find out investors attitude towards government securities, its issue policy, process and practice etc.

In Nepal, most of the investors do not invest their funds logically. They normally invest using their interest, intuition, imagination, guess work etc. Mr. SS Grewal Says "if is not even a wholly rational or logical process which can be understood in terms of conventional reason and logic since it involves the reason and logic since it involves the use of intuition, imagination, guesswork, conscious judgment based statistical probabilities" (*Grewal, 1995 : 147*).

Mr. Gopal Prasad Bhatta Says- "In Nepal most of investors invest their funds in single security rather they can be benefited in portfolio of

securities through diversification of risk". (*Bhatta, 1995*). Therefore, most of investor designs their investment and financing activities in a manner to maximize the market value of shares rather than systematic investment most private organization's stock have been listed in the NEPSE. People make investment decision on the basis of information provided by NEPSE. Investors may invest in the government securities or private organization's bonds. Government securities are risk less investment as comparing private securities. The study relates on these problem.

- a) To find out cause of high marketability of government securities.
- b) To find out investor's attitude towards government securities and
- c) To know securities issue system and practices.

### **1.6 Objective of the Study**

This study is entirely related to internal debt. The overall objective of this study is to analyze the policy of Nepal Government securities, issue system and practice of government securities and investment preference towards government bonds issued by Nepal government depending upon yields, face value, maturity period, cash receipt etc.

However, the following objectives are focused for specific study.

1. To analyze the trend and structure of government securities in Nepal
2. To examine the attitude of investors towards government securities.
3. To overview the issue systems and practices of Government Securities.
4. To recommend for the improvement based on the research findings.

### **1.7 Significance of the Study**

This study is expected to make a clear concept on government securities while making investment. Government Securities are safe, marketable

and liquid instrument to invest the funds. Only government securities have systematic market for the prospective investors. Therefore, an independent study in this sector is significant to give information about the government security market by analyzing the trend of investment and their yields. This study gives information about short-term government securities and long-term government securities.

The government issues are less risky issues. So, risk averter investors normally invest in the government securities. This study will prove helpful to the individual person, a group, and any institutions who want to know about government issues. This study will be usable and valuable for academicians, teachers, student and any institutions who want to know about government issues.

### **1.8 Limitations of the Study**

Due to the limited resources and time available, the study has been limited by following factors.

1. This study is based on the published secondary data as well as primary data.
2. This study covers a time span from the F.Y. 1987 through F.Y. 2008.
3. This study is not related to external government debt.
4. This study is not related to macro economics like inflation, monetary policy etc.
5. Questionnaire will be administered and interview will be conducted with in Kathmandu valley only so the hypothesis test not shows the result of general people. It is limited for the people of Kathmandu Valley only.

## **1.9 Plan of the Work**

The whole study has been divided into five chapters.

- **Chapter – 1, Introduction**

This chapter includes the introductory framework of the study that contains general background, statement of the problem, objectives, significance of study and limitation of study and plan of the work.

- **Chapter – 2- Review of Literature**

This chapter includes the review of previous research in this field, books journal, unpublished thesis and independent research on related field.

- **Chapter – 3 – Research Methodology**

This chapter includes the research methods, research design, data collection procedure, data analysis tools.

- **Chapter – 4 – Data presentation and Analysis**

It concerns with the application of defined research method on the collected data and information. The general result after the application of research method on data has been analyzed and interpreted in this chapter. And this chapter includes the major finding of all analysis.

- **Chapter – 5 – Summary, Conclusion and Recommendations**

It summarizes the whole thesis report presents the concluding remarks with a suggestive package as recommendations. And at the end of this study bibliography and appendices are also included.

## **Chapter-2**

### **REVIEW OF LITERATURE**

#### **2.1 Conceptual Review**

##### **2.1.1 Historical Background of Government Securities**

The public debt may be internal and external. The idea of public debt was originated in the Great Britain in the seventeenth century, where a group of city merchants provided grants and loans to the government. In return, they received the privilege of royal charter to fund the bank of England, which became country's central bank.

The first public issue of government securities took place in Holland in 1542. To raise the necessary funds, the government of Holland issued various securities, the interest to be funded from excise and property taxes enacted for the purpose. Some of these securities were transferable and therefore suitable for resale, and there developed a limited secondary market. Similarly, the first English government security was issued in 1693. In 1694, it chartered the bank of England to buy government securities. Alexander Hamilton issued the first U.S. government securities in 1790. The idea was copied from these countries worldwide (*Meir, 1999 : 494-495*). Historically, during the period of world war, the government borrowed large amount of loans to meet its expenditure. Now every state should after the economic development and welfare in addition to conventional work activities. Therefore, the public debt has become one of the most useful instruments to generate income and to maintain the welfare state and to develop the country.

Government sells various securities to raise funds in the market. Such as Treasury Bills, National Saving Bonds, Development Bonds, citizen Saving Certificates, Special Bonds. These Securities are called government Securities. Government issues various types of securities



both internally and externally. Government bond is an important source of public debt. Government issues various securities as per the appeal of investors. The internal investors of government are the people of the country. Government Securities are the normally less risky than others corporate securities. Therefore, the subscription of government issues does create serious problem in the market.

There was no knowledge of Government bond at the time of Kirat period. However, there must have been some method of revenue collection. Taking into account the Mithila Kingdom during the Ramayan period, king Birat's Kingdom during the Mahabharat period and Gautam Buddha's father's Kingdom Kapilvastu, it is defined that these kingdoms must have generated revenues through taxes and levies on the simple logic that there were many state administration and recruiting soldiers. Thereafter, in the middle Ages, borrowing was a rare event and it was undertaken in small amounts and that after great difficulty. Most of the borrowing was under taken by the rulers for financial wars. Such borrowing was not approved by the society. It was considered dead weight debt. Every year the government has been issuing securities and collecting huge amount of money from public to uphold deficit budgetary system of the country. Thus the primary reason for the issuing government securities arises due to deficit budget declaration in Nepal. Deficit in budgetary system has been normal features since the first budget. The increasing trend of government budget has been balanced by borrowing from public. It is believed that government plans towards people's welfare including maintain balance of peace in the country. Therefore, the issuance of government to work for the economic development of the country. Therefore, the issuance of government securities to meet government expenditure is important to raise the living standard of people. But the lack of proper utilization of the raised funds is said to have caused many problems.

In Nepal, the public debt was first raised in 1961 with the issue of Treasury bill. Thereafter the government has been issuing development Bond Special Debenture Bond, National Saving Bond and such other Securities to raise the fund internally and externally. The NRB which the Central Bank of Nepal issues various Government Securities on the behalf of Nepal Government. The Bank issues various Government Securities after analyzing the liquidation position of market, private investment opportunity, average interest rate in the market, inflation attitude of people toward risk bearing capacity, etc. The bank issue long-term securities and short-term securities. The bank chares government 0.25 percent commission on transaction amount. Similarly, Nepal has also started to borrow from external sources since F.Y. 1964/65. Since then Nepal has to bridge financial resource gap in her budgetary position contributed to increase each year. The main source of the external borrowing of Nepal are the government of developed countries, international agencies and commercial bank mainly the International Monetary Fund (IMF), World Bank (WB), Asian Development Bank (ADB). In April 2001, the Bank floted the long-term security named “RBP 2062 Na” of Rs.1000 m. at 9% interest (taxable) for which buyers applied for more than issue amount with in a few hours. Similarly, in 2062/4/1 and 2062/9/1 the bank floated securities named Special Bond 2067 and 2062 Ga of Rs. 105.57 and 10.32 lakhs respectively.

### **2.1.2 Theoretical Aspect**

The government bond can be defined as the loan taken by government through the issue of securities. The concept of government loan had come into practice after 19<sup>th</sup> century. In the modern era, the function of government has been increasing day by day. The present economic problem of the country including maintaining peace may be the main reason behind raising government loan. Normally, the income or revenue

generation is less than expenditure every year, so it is necessary to raise funds by issuing government securities.

It is widely accepted that the mobilization of internal resources is an important factor for the development of economic condition of a nation. International resources can be mobilized from two sources. First by collecting revenue (mainly tax revenue) and second is internal borrowing. Nepal Government has adopted internal borrowing as an easy tool to adjust budget deficit. In developed countries public borrowing is preferred for creating employment opportunity and maintaining economic stability but in underdeveloping countries like Nepal growth in productivity is basically a great need from the use of government borrowing.

Government collects tax and other revenue. It is the main source of government income. Public debt is the temporary source of income for government as it is returned back to the holders after its maturity period. Government issues securities for funds. Treasury Bills are short-term loans and Development Bond, National Saving Bond and Special Bond are long-term loans.

Every government needs funds from different sources to carry out its functions therefore, every government considers the different sources of revenue e.g. by levying different taxes, duties, fees and fines on the people residing or coming within the jurisdiction of its power. The revenue raised by exercising its taxation power depends upon the functions it needs to perform and in turn depends upon the ideology it is pursuing. If a government wants to regulate the activities of the people more, it needs more revenue and consequently, it squeezes the people more. Normally when tax collection alone is not sufficient the government

issues various types of securities for raising the essential funds. Government bond is one of the important sources of public debt.

The public debt has been discussed by several economists in 19<sup>th</sup> century. It has also been discussed by modern economists. Keynesians and their views towards public debt are centered on its size and use. Most of the student having economic background have discussed and analyzed public debt and some of these have focused on its structure and importance where as others have focused on its burden and impact on inflation, employment national solvency etc. have been discussed by these thesis paper. Therefore the present study has focused on the practices and systems of government bonds in the context of Nepal. This study is only related to internal issue of government securities (Internal debt).

In the 20<sup>th</sup> century, almost all democratic government borrowed on large scale such borrowings have been made easy because of the development of capital market, increased confidence in the stability and integrity of the government and social sanction for welfare expenditure.

Deficit budgetary system in Nepal is the causes for the issue of government securities. The government prepared a national budget for the first time in 1951 and enforced it and has been suffering deficit since the first budget. The increasing trend of deficit budget has been meeting by borrowing from public. When government expenditure exceeds revenue, deficit must be financed. So, government has to issue government bond to fulfill long-term need of the government and treasury bill for short-term.

Generally, public debt refers to loan raised by the government with in the country or outside the country. Phillip Taylor says "Government debt

arises out of the borrowing by the treasury from banks, business organization, and individuals. The debt is in the form of promises by the treasury to pay the holders of these promises a principle sum and in most instance interest on principle". Government loans should be return back to holders after certain period. So it is not desirable to raise funds from public in every action taken by the government.

Deficit financing in the form of internal borrowing could be another source of internal resources in development finance of Nepal. Government of Nepal is regularly using internal borrowing as a significant source of finance to meet the budget deficit. "During the sixth plan period 23 percent of the total development expenditure was financed from internal borrowing as against the target of 9 percent. The contribution is estimated to be 12 percent only during the seventh plan period, however in actual the contribution of internal borrowing to the total plan outlay was increased considerably during the plan period." *(Bista, 1986)*

The government of under develop countries can raise resources through public loans in term of two important methods. First, selling the government security to the public that are bought and sold in the capital and money market and of which market prices are quoted. This may be called market borrowing. And the second is the funds borrowed by the issue to the public, which is not negotiable and is called non market borrowing. *(Tripathi, 1968 : 316)*.

"Public debt may be internal or external when it is held by the subjects of the indebted government; it is an internally held debt. In this case, the community owes this debt to some of its own members. The debt will be external, if the creditors are foreigners and there is drainage of national

resources in favor of foreign countries when the debt is served, it is clear that if loan obligations are allowed to change hands.” (*Bhatia, 2000*).

For the maintenance of the debt either effort has to be increased or the level of national incomes has to be increased. Here, the point to note is that the import is also increasing sharply which affects adversely for the current account balance and thereby the increase in borrowing. In developed countries, internal debt has assumed great importance in view of the increasing magnitude of budgetary deficits. According to Philip Kotler “government debt arises out of borrowing by the treasury from banks, business organizations and individuals. The debt is in the form of promises by the treasury to pay to the holders of these promises principal sum and in most instances interest on the principal. Borrowing is resorted to in order to provide funds for financing a current deficit. (*Bista, 2000*).

Borrowing is the major source of government financing. People have an option either to invest in government securities or private securities. Government issues risk-free securities so almost all of the risk-averse investors invest in government securities rather than private securities. Author Mr. Due and Friedlaender says- “The government can borrow more cheaply than individuals because of lesser risk.” (*John, 1998*)

Public borrowing is treated as a source of revenue like raising funds from tax but the collected funds should be returned back to the holders within the maturing periods. Borrowing may be from banks, from public or from abroad. Likewise it is important to note public expenditure. **Mr. Dilli Raj Khanal says**-“In the context of Nepal major public expenditure categories come under economic services, social services, defense, administrative and miscellaneous services”. (*Khanal, 1988*). Thus public expenditure

can be classified into two main categories (1) regular expenditure and (2) Development expenditure.

“The importance of government finance in underdeveloped countries like Nepal may be appreciated in terms of the strategic role, which is the government of such countries have to play in initial stages of development. In the first place, It has task of government to create some minimum preconditions of development such as building of social and economic overheads, which do not generally attract private investments for one obvious reason that such investment works usually require huge resources but do not promise immediate returns. Even it provides individuals are interested in such investment works, divergence between private and social gains from the overhead facilities justifies their ownership and management by the government it self in the interest of community at large.” *(Shrestha, 1981 : 210)*.

The resort of security market by the government has been only in the form of borrowing mainly through the issuance of development bonds to meet the budgetary expenses. The first series of development bond were floated on February 12, 1964. It carried 6 percent rate of interest and had the maturity period of five years. Since then, the government has been floating the development bonds each year. Till 1981, it had floated fourteen issues of such bonds carrying the interest rate ranging from 5 percent to 10 percent and with maturity period varying from the five years to ten years. The magnitude of funds raised through this method also has been rising each year. **Mr. R.S Mahat explains**-“Government has virtual monopoly over the security market”. *(Mahat, 1981 : 25)*.

Government borrowings are classified two types. Purely internal debt exists with in a nation. The internal debt refers to the situation where by the borrowing unit acquires the money from itself (lends to itself).

External debt is a condition whereby the borrowing units may be a unit of government, a business or a consumer. Size of political Jurisdiction essentially determines the internal borrowings limit of government debts.

Internal debt refers to amount raised from Treasury bills, Development bonds, National saving bonds, special bonds, International Monetary fund's (IMF), promissory Notes. Among these different governments' securities and IFF, promissory notes, Treasury Bills is the short-term securities.

### **2.1.3 International Study**

The author of this thesis has tried to collect material from others sources as well. In the process of collecting material, the recent technology, 'computer has been used. The internet has been made to collect relevant information required for study. The study of bank of Thailand is somewhat relevant and the purpose of issuance of the government securities has been explained in this study. These have been considered for the preparation of this report. The bank of Thailand took over the following four bonds after its establishment in 1942. The ministry of finance entrusted the Thai National Banking Bureau to manage bond sell as follows. [www.bot.or.th/bothomepag/bankatwork/bond/features/bond/bondpage-e.htm](http://www.bot.or.th/bothomepag/bankatwork/bond/features/bond/bondpage-e.htm)).

- ❖ Loan Bond for the Cooperatives 1940, a bearer bond issued in the amount of 20 million that with 30 year maturity at 4.5 percent interest per annum. The purpose was to raise capital for cooperatives to lend to their members.
- ❖ Loan Bond for municipality 1940, a bearer bond issued in the amount of 20 million bhat with 30 year maturity at 4.5 percent interest per annum. The purpose was to raise fund for lending to public organizations or entrepreneurs.



- ❖ Loan Bond for Industrialization 1940, a bearer bond issued in the amount of 20 million bhat with 30 year maturity at 4.5 percent interest per annum. The purpose was to raise fund for lending to public organizations or entrepreneurs.
- ❖ National Loan Bond 1940 and National Note, issued in the amount of 8 million bhat with 10 year maturity, respectively. The national Note was a bearer note sold for 5 bhat per unit, redeemable for 6 bhat per unit. The purpose of the two borrowings was to compensate the treasury reserve spent on the Indo-china war.

Thus, the government of every country has different purpose for issuing different types of bonds. In 1945, the Thai government made short term borrowing for the first time by holding auction of Treasury Bill with maturity period of less than 12 months, in accordance with the Treasury Bill act 1994. In terms of long term borrowing issuance of government bonds was used as a tool. Issuance of both treasury bills and government bonds was backed by loan acts issued for specific purpose.

It was until 1960 that the government issued the “budgetary Appropriations Act (No.2) 1960” as ascended from the Budgetary Appropriations Act 1959 in some major section concerning borrowing. When budgetary expenditure, annual expenditure or additional budgetary expenditures previously promulgated exceeded budgetary revenues, the ministry of finance were improves to borrow for expenditures as needed. However, such borrowing must not exceed 20 percent of budgetary expenditures plus additional budgetary could draw on overdraft facilities at the bank of Thailand. As the first national economy and social development plan (1961-1966) were launched, the government in each year had to increasingly secure fund to compensate the budget deficit through domestic borrowing.

“Treasury Bonds are the government’s way of borrowing money, so lower deficits mean a smaller supply of T-bonds and higher prices. With bonds, higher prices are equated with lower yields” (*www.bot.or.th*). Therefore, the government gets to borrow money at lower interest-rates. The impact ripples across all other interest rate-bearing securities and creates a lower interest-rate for stocks, which is bullish. The higher budget deficit, the more Treasury notes and bonds the government must sell to finance its operation.

The government of Canada has been issuing various types of government bonds. They have been issued by different governmental bodies. They issue different types of government bonds. In Canada, investors have different attitude while they are making investment towards government securities due to various government bodies in the country. They have authority to issue securities. The following agencies are responsible for issuing government bonds in Canada as follows: (*www.fanpipe.com*)

**a. National Government**

The “central” or national governments also have the power to print money to pay their debts, as they control the money supply and currency of their countries. This is why most investors consider the national governments of most modern industrial countries to be almost “risk-free” from a default point of view.

**b. Provincial or State Government**

Provincial or state governments also issue debt, depending on their constitutional ability to do this. Canadian provinces notably Ontario, borrow more than many smaller countries. Most investors consider provincial or state issuers to be very strong credits because they have the power to levy income and sales taxes to support their debt payments. Since they cannot control monetary policy like national governments, they are considered lesser credits than national governments.

### **c. Municipal and Regional Government**

Cities, towns, counties and regional municipalities issue bonds supported by their property taxes. School boards also issue bonds, supported by their ability to levy a portion of property taxes for education.

### **d. Supranational Agency**

A supranational agency, such as the World Bank, levies assessments or fees against its member governments. Ultimately, it is this support and the taxation power of the underlying national governments that allow these organizations to make payments on their debts.

### **e. Quasi-Government Issue**

Most of the government related institutions issue bonds, some supported by the revenues of the specific institution and some guaranteed by a government sponsor. In Canada, Federal government agencies and Crown corporations issue bonds. For example, The Federal Business Development Bank (FBDB) and the Canadian Mortgage and Housing Corporation (CMHC) bonds are directly guaranteed by the Federal government. Provincial crown corporations such as Ontario Hydro and Hydro Quebec are guaranteed by the Provinces of Ontario and Quebec respectively. The practices of government bonds are very important in United States. In the context of this country, the normally consider Treasury securities as government securities (*ibid-www.bot.or.th*).

Treasury securities are sold at public auctions on the regular schedule. The competitive bids at these auctions determine the interest rate paid on each issue of Treasury bills, notes or bonds. The competitive bidding is done by primary dealers, a group of about forty securities dealers. Who are authorized (and obligated) to submit competitive tenders at Treasury auctions. These dealers can hold them, resell them to their clients or trade them with others securities firms.

## **2.2 Attitude toward Government Debt**

Most of the government in the world collect fund from two sources, namely, Public Revenue and Public borrowing. These are the source to fulfill the budget expenditure in every country. The views of different economists at different time periods on matter of public borrowing are presented as under.

### **2.2.1 Classical View**

The classical economists had negative attitude towards public debt and they did not plead for increasing economic role of government. Instead they said that, “let money fruiting on the pockets of the people”. According to them state has to perform its limited activities, maintenance of law and order, justice and social security. Classical economists like J.B. Say, J.S. Mill, T.R. Malthus and C.G. Buttable have given their argument that “Debt creates burden in the economy because of its unproductive nature”.

The classical economist Adam Smith opposed any use of public debt. He looks public debt as leads to extravagance, encouraged resort to was and induced generally disadvantageous economic conditions for the nation, which employed it. Similarly, Bastable (1964) observed, a nation can't, any more than an individual keep adding continually to its liabilities without at least coming to the end of its resources. They also taken public debt is no longer a cake eating feast but rather a careful and efficient brain to handle the management of the public debt. In this context Shiras opines, as government must remember that borrowing is not a short cut to prosperity and a policy of borrowing must be retreated except for what can reasonably be regarded as productive expenditure. (*Lekhi, 1995 : 147*).

In the case of public debt classical economist were generally against the public borrowing. Actually, most classical author favored against public borrowing. They favored minimum public expenditure and favored taxation and borrowing. The reasons of their favor for taxation are as follows:

- I. Deficit financing means an increase in public debt. Since it is an easy method of obtaining income, government is likely to be extravagant and irresponsible consequently, public debt will become a definite burden in the economy.
- II. Payment of interest on public debt and refund of the principle will require additional taxation. It might prove to be difficult since government's power to tax is not unlimited.
- III. Deficit financing might be produced currency deterioration and price inflation.

The classical philosophy propounded by Adam Smith and his supporters have viewed laissez-fair equates a sound and balanced budgetary policy that doesn't consider the fiscal deficit and hence public borrowing. The classical says that "just as private economic units should not run into a persistent deficit. Moreover they state if debts are indispensable and inevitable for a particular period of time it should be paid if as soon as possible. It should, however, be kept in mind that classical economists were not against all types of public debt. They approved public debt for productive purpose.

### **2.2.2 Keynesian View:**

After the great depression of 1930's, J.M. Keynes, who advocated for increasing government role in then economic activities by adopting deficit financing so that effective demand is created in the economy ensuring employment opportunities. He advanced the concept of under

employment equilibrium and who effected a truly significant revision in the theory of public debt, Keynes argued that if debts are internally held, there is nothing to worry about their size, such debt involves merely a series of transfer payments and they cancel out for the economy as a whole. Hence the only concern should be about economic stability at high levels of income and employment. Keynes also stressed and challenged the version of classical economists and hold opposite opinion on the subject of burden of public debt. He submits that there is no shift of the basic burden to the future generation because the same posterity which pays the additional taxes will be benefited from the repayment of the debt. Thus is the Keynesian theory of public debt is emphasized. Keynes' revolution brought change in the role of public borrowing. Keynes held the view that increases in the public debt through multiple effects would raise the national income. It is because Keynes correlated public borrowing with deficit financing. He authorized the government to borrow for all purpose so that effective demand may also increase.

Many Keynesians carried this analysis to the other extreme and held the view that, if debts are internally held, there is nothing to worry about their size. Such a debt involves merely a series of transfer payments and they cancel out for the economy as a whole. Hence the only concern should be about economic stability at high levels of income and employment.

A.P. Lerner maintains the theory that the government should borrow only when it wants to make people hold more bonds in place of money. This action will raise the rate of interest by lowering the value of bonds and will prove to be anti-inflationary. In the event of falling aggregate demand and shortage of funds for productive investment, government should lend to the private sector or increase its own expenditure to arrest the fall in

real income and employment. The government may also borrow from the central bank to retire the debt held by the public.

### **2.2.3 Post Keynesian View:**

Post Keynesian economist advance their idea that government borrowing does not always deprive the private economy of resources as for instance, in a period of widespread unemployment. It is also not accepted how that borrowing in a period of full employment must be inflationary. It depends on these circumstances if borrowing taps funds otherwise spent in consumption, it is not more inflationary than taxation. A large public debt, if internally held, poses many problems of the economy. They think that income, saving and investment are the crucial factor to achieve steady growth for developing countries. So the overall aim of borrowings is not to equalize income in different countries but to provide every country with an opportunity to achieve steady growth, on the other side, people in the developed countries are enjoying high prosperity, high standard of living, high educational facilities etc. population problem is also not so serious in such economies.

Many economists argue that borrowing today constitutes a burden for the future. A large public debt, if internally held, poses many problems in the economy. It complicates monetary policy and creates difficulties of management. Both classical and Keynesian economists agree that a distinction should be made between an internal and external debt. Internal borrowing is largely an act of expediency by a government when it prefers to finance its expenditure by taxation but finds it inconvenient to do so. In the event of seasonal fluctuations of spending or revenue or errors in budget estimates, a government may resort to temporary borrowings. In case of an emergency it is better to borrow than to go for a sharp increase in taxation.

According to Richard Goode, a better argument in form of internal borrowing should be avoiding borrowing to pay for government consumption expenditures. Domestic borrowing is a use of national saving. "The inference is that future to restrict borrowing to the finance of investment will retard economic growth. A weakness of the argument is that not all outlays classified as investment actually contribute to growth, while some expenditures usually classified as government consumption promote growth." (*Gode 1984 : 98*).

### **2.3 Recent Thinking on government Borrowing:**

Many economists and analysts have keenly studied on government borrowing in the country. Some have criticized and some have taken it as very good prospective in the country.

All public debt is not burdensome in the country. Some economists suggested that it is essential to raise idle funds from public by issuing government bonds.

Public borrowing has a great role in emergency expenditures or war expenditures. It also plays an effective role in macroeconomic stabilization. A discretionary increase in public spending to cure unemployment was a Keynesian prescription. In the country, a part of recurrent outlays could be met out of public borrowing.

Chelliah observes that the ideal situation is one in which first, revenues will meet subsidies, other transfers, interest payments and the greater part of current expenditure, debt finance will be used for meeting the government's non-remunerative capital formation, a proportion of current expenditure designed to increase social capital and productivity and the requirements of financial investments; and second, the total of domestic borrowing will be determined in such a way that, given the rate



of domestic saving, the non-government sector will be able to obtain a due share of saving and there will be no need borrow from the central bank more the correct amount of seignior age.” (Rijal, : p-208).

The level of government borrowing is a function of the ability and willingness of persons and business to lend and the government’s power and intention to tax. Minimum level of debt can be expressed in terms of the following equation:

$$D = \frac{Y - O}{R}$$

Where,

D= Maximum sustainable national debt.

O = Constant expenditure for ordinary government operation

Y = Maximum ratio of tax receipts to national income (T), and

R = Contractual interest rate of government debt

#### **2.4 Effects of Government Bonds**

Borrowing has a number of effects and these can be taken on the following headlines:

- i) If a country borrows too much money, it has to pay a great deal of interest every year in order to service that debt. This represents money that could have been used to pay for program spending instead. By borrowing money, the government has placed a greater emphasis on spending in the present than in the future. It has discounted the value of future expenditure.
- ii) Depending on how much money the citizens of that country or that province save out of their own incomes, the borrowing government must sell its obligations to foreigners. By doing so, the government makes itself vulnerable to the shifting and often volatile sentiment of the international capital markets. If they have a sufficiently large

- external debt in relation to their GDP (as an indicator of their current and future capacity to repay), speculators might attack their currency or their countries bond markets forcing interest rates higher and causing the value of their economy to degrade in international terms.
- iii) Indeed, an excessive debt policy can lead to a vicious cycle of speculative attacks, followed by higher interest rates and higher interest payments that can cause an economic slowdown. Just when a stimulate policy is required to help the economy struggle back to its normal growth trajectory, the government finds itself crippled by high interest rates and poor liquidity. Nobody else will lend the government money with which it can stimulate the economy under anything but the most onerous terms.
  - iv) The vicious cycle is one that has plagued economics of the Third. World and particularly Brazil, for years. On the other hand, it may be prudent to borrow during those funds (and thereby dampening the technology) in times of economic growth.

“The growth of national debt may not only make some people richer and some people poorer, but may increase the inequality of distribution. This is because richer people can buy more government bonds and so get more of the interest payments without incurring a proportionately heavier burden of the taxes.” (*Houghtom, : p-371*).

Most people would agree that is bad for the country because it creates burden for paying regular interest and at the time, it should be back for the investors. Similarly, it has been argued by many authors that there is no direct money burden of internal debt as money is only transferred from one group to another. When interest on debt is paid by levying taxes, money is transferred from the tax payers to the bond holders. As

regard payment of the principal sum, the future generation will bear the burden. In this case also, money remains within the country.

The burden of Government debt is not analogous so that of private debt. If the debt is internal to the country, interest payments and future retirement of the debt do not acquire that resources be transferred outside the country. Thus, except for some side effects, the goods and services available to the economy remain unchanged. (*Eckstein, 1987*).

One clear burden of a government bond is reduction in output that is existence causes. To the extent that the taxes necessary to meet the interest payments have disincentive effects and cause a misallocation of resource, the debt does reduce output. If the debt also reduces investment, the future inherits a smaller capital stock and hence less potential output. A growth of debt can also add to inflation.

Economics have explained different types of burden of government bond as direct, indirect, monetary and real and it tend to fall either on the present or sometimes on the future generation. Direct money burden is measured by the extent of money payments involved and the rise in taxation needed. Direct real burden is equal to the loss of economic welfare on account of the direct money burden of increased taxation. Indirect burden of debt, however, refers to the extent of adverse effect of increased taxation on the level of production.

## **2.5 Ownership, Marketability and Term Structure of Government Bonds**

Ownership, marketability and term structure are important considerations in managing the government bond.

### **2.5.1 Ownership**

The people and organizations that lend money to the government by purchasing government bonds are the owners of the government bonds. The U.S. government had divided its owners into three categories, according to debt held report from 1951 to 1976, the largest portion of the government debt is owned by private investors, including banks, insurance companies, corporations, private individuals, state and local governments (which are classed as private investors because their decision to buy bonds is voluntary and based on ordinary financial management considerations). The second largest portions of the debt are held by government accounts, such as the social security and highway trust and the reserve of retirement programs for federal government employees. The smallest portion of debt is held by the Federal Reserve Banks. These banks acquire government bonds in the process of money creation. They may purchase bonds to help the U.S. Treasury government to cover a deficit in the budget.

The debt owned by private investors represents genuine borrowing by the Federal government. (*Wayland, 1978 : 161*). This borrowing involves a transaction between the government and investor who agrees to transfer funds to the government in exchange for the receipt of periodic interest payments and eventual repayment of the sum loaned. Interest payments are necessary to persuade investors to purchase these bonds, and the maturity debt, which is part of the conventional bond agreement, obligates the government to repay the principal at some specified date. Genuine borrowing withdraws funds from the private sector of the economy and therefore has effects on the equilibrium level of national income similar in many respects to those of taxation. Taxation, however, is compulsory, genuine borrowing is a voluntary transaction.

Thus bonds owned by government accounts are not money creation indebtedness because the money used to purchase them has come from taxes collected from the public. But bonds do not reflect genuine borrowing in the sense of voluntary transaction between the buyers and seller.

### **2.5.2 Marketability**

The government in a country issues bonds that are normally marketable which means that person who owns such a bond may sell on mutual agreement. Therefore the marketability of these bonds can fluctuate depending upon the interaction of demand and supply. In United States, some U.S. government bonds are marketable.

Markets for government securities are important for their size. A government security plays special roles in the economy. The interest rate on government securities is the risk free rate against which all other interest rates are measured. In many countries the central bank regulates the quantity of money by buying and selling the government securities. (*Meir 1999 : 494*).

### **2.5.3 Term Structure**

The term of a debt instrument is the length of time that must elapse before the obligation matures and the principal sum of the loan must be repaid. The treasury issues a variety of different debt instruments, some with short term maturities of a few months and some with long-term maturities of twenty or thirty years. At the short end of the term structure are Treasury Bills, which mature after 90 or 180 days from the date of issue. Treasury Bills are sold on a discount on the basis of competitive bidding, which means that the rate of interest actually paid on each issue is determined only after the issue has been sold. Because the time period is short, the risk incurred by buyers is low, interest rates

on Treasury Bills therefore are typically the lowest in the family of government debt instruments. Treasury Notes are intermediate term instruments and have maturities of from one to five years. Interest rates on Treasury Notes ordinarily will be somewhat higher than those on Treasury Bills because the longer maturity time exposes the buyer to greater risk. Bonds have many characteristics such as the way they pay their interest, the market they are issued in, and the currency they are payable in, protective features and their legal status.

Bond Characteristics are as follows:

- Bonds have their fixed interest
- They have particular market they are issued in.
- They are currently payable in and protective features.
- They have their legal status
- They are issued by like government, corporations, special purpose trusts or even non-profit organizations.

#### **2.5.4 Terms used in Bonds**

##### **I. Coupon**

The fixed interest paid on a debt instrument expressed as a percentage of the face value for its whole life is called coupon. In Thailand, the coupon is usually paid on annual or semi-annual basis.

##### **II. Par Value**

It is the apparent worth i.e. the nominal value of bond, which appears on the face of the debt instrument. The amount of par value is repaid at maturity also known as face value.

##### **III. Price**

It is price, which is set for purchasing or selling the securities in the market. It is expressed in rupee amount.

#### **IV. Yield**

It is the income from an investment in debt instruments expressed as a percentage of purchase price or current market price.

Treasury Bills, National Saving Certificates, Development Bonds and Special Bonds are the government debt securities; they are issued to recover the deficit budget. Treasury Bills are short-term money market instruments having low return and low risk. Commercial Banks mainly hold Treasury Bills to manage their cash balances. National saving certificates and Development Bonds are two long-term marketable securities, both are contributing one third of total internal debt. Special Bonds are specially sold to NRB and Commercial Banks. Coupon payments fixed on special Bonds are below the market rate. Special Bonds constitute 40 percent of the total internal debt; have the longest maturity period of about 20 to 25 years and highest risks associated with uncertainty of the longer term.

National Saving Certificates and Development Bonds are the long-term marketable securities available in the exchange market. Market makers facilitate the secondary market transactions of marketable government securities. Settlements of payments are made through NRB. Nepal Stock Exchange Ltd. has not yet started transacting government securities in the floor. Buying and selling orders cannot be placed through electronic means and exchange of government securities.

NRB and Commercial banks are the main holders of government bonds. The share of NRB decreased from 51 percent to 38 percent in 2000. Shares of Commercial Banks and individuals were 26 percent and 24 percent respectively in 1996 and increased to 33 percent and 28 percent in 2000.

Government loan has the all-financial obligations of the nation including its currency or s government borrowing. In many cases, the currency is not included in government debt. Moreover, some of them do not include even the overdraft amount from NRB, which must be refunded by the government to the bank within a time limitation.

Government Securities classified as two types in terms of internal public debt. They are explained below:

**a) Short-term government debt:** Short-term loan is collected by issuing the short-term government securities such as, Treasury Bills. They mature less than one year. In Nepal, Treasury Bills are sold at discount and pay no interest with the appreciation in value to maturity, which represents investors' return. The NRB (on behalf of government) offers various parties for the sale of government securities, for example, Commercial Banks, Development Banks, Government and Non-government Financial Institutions, Group of Investors, etc. Treasury Bills matures after 91 days. Sometimes they are issued 364 days with maturity. Such securities are understood auction system. The party who submits the higher amount of cash can purchase the Treasury Bills floated by the NRB.

**b) Long-term Government Debt:** The floating government debts are divided into the bonds and notes. They are issued to provide the funds for sustainable development of the nations, to make the people contemplative to the pride of participation in nation's development and welfare, to draw the liquidity from the market for a long run. Government issues Development Bonds and National Saving Bonds with a long-term maturity period. These bonds are issued for a long period. The government also issues Special Bonds, which are in practice today.



### **2.5.5 Objectives of Government Debt:**

There are various objectives in issuing government securities. "In the past, the way of living was very simple and the borrowing was not very significant. The government budgets were very small. The governments also followed the policy of non-intervention in economic system. But in modern times, especially after the world depression of 1930's, the public authorities have started to taken keen interest in the economic development of their respective countries". (*Lekhi, 1995*).

The objectives of government securities are summarized below on the following headings:

#### **i) To recover the deficit budget:**

The most important aim of public borrowing is to fill the gap between the revenue received by the government and proposed expenditure during the year. Modern governments do not have piles of cash or treasure to meet any budget deficit. Normally, the annual expenditure proposed by the government for the running year should be and is met by the annual revenue. But because of many unexpected and unplanned circumstances, the yield from the taxation and other sources may not be equal to actual expenditure. This is why the government raises funds through the issue of securities.

#### **ii) To restrain inflation:**

It is a condition that we are suffering from the pain of the gradually increasing prices in the market. In other words, we are surrounded by the phenomenon where too much money chases too few goods. In these conditions the government can withdraw a large volume of money from the public to check prices from increasing. \thus the best way to curb private spending is to borrow from the people, so that can not flow the

more cash in the market. Hence, the government can counteract the economy from the hyper-inflation and maintain the economic stability.

**iii) To know unpopularity of taxation:**

Most of the people are not interested to pay the taxes to the government. The tax will be resented by the people whether it may be old or new. People always opposed the enhancement of old rate of tax and the announcement of the new ones. The government through this device can protect itself from the critics of people in regard of levying the tax but it may leads the nation to grim predicament in long run.

**iv) To maintain economic growth:**

The state should conduct the general administrative functions and development programs simultaneously. The government should implement the construction of public works like roads, railway lines, irrigations, powerhouses, etc. for accelerating its economic and social progress. Underdeveloped countries on one hand cannot use their natural resources due to the various constraints and on the other hand these cannot levy heavy taxation upon their people due to the low rate of real saving of their people. In this situation, borrowing from the people and abroad would be the main and only device of getting financial resources in the nation.

**v) To meet unexpected expenses:**

Sometimes the government borrows from the people to meet the unexpected expenses due to floods, famines, earthquakes, major accidents, epidemics, etc. Such terrible incidents lead the nation to a sudden spurt of the government expenses.

On the other hand, there are a great tussles and enmities among the powerful countries for their economic and political supremacy and many

other interests. And relatively powerless countries are also bearing the incessant tensions among their neighbors for their respective interests. In this very tense situation, war is the most probable at any time. Now a day, war is becoming very expensive. Of course, a country needs a large amount to maintain its defense service and up to date equipment if it wants to protect itself from its internal enemies or terrorism and foreign aggression and attack. These all cause the nation to be indebted.

**vi) To allocate resources properly:**

Specially, the country having the capitalism economic system is not directly liable for its resources allocation. In this and similar other conditions, the country on one hand adopts the progressive tax system and on the other borrows huge amount of money from the capitalists so that the borrowed amount could be redistributed towards the poor people in the country. So the borrowing is justifiable in terms of better allocation of resources.

Apart from these all-public loans in modern times are necessary to remedy the business depression, to check the cyclical fluctuations, to finance public enterprises for public welfare to create the infrastructures, for establishment of socialistic state and even for meeting the current and regular expenses. It should be noted that different types of loans would be raised for different types of objectives.

**2.5.6 Impacts of Government Debt:**

The government debts as well as taxation transfer the purchasing power of people to the government. But in due cause of time cash collected through the taxes and debts is transferred to the people when the state launches the development programmers in the society. In this way, people's property reaches to the people's in another form. However, the cyclical transfer leaves some impacts in macroeconomic situation of the

nation and also common public behavior, such as effects of consumption, investment, distribution of income, production etc.

## **2.6 Literature Review in Nepalese Context**

Number of intellectuals has made the several studies and research in the field of public borrowing. Some of those articles, thesis and project report related to the subjects and included in this thesis are as follows:

### **2.6.1 Review of Article**

**Mr. Nara Bahadur Thapa** in his article 'Adhoc treasury bill versus ways and means advanced debate on their implication for monetary policy says-'Government borrowing from the Central Bank is not considered good because it collects funds regarding for money print' (Mirmire, volume 164).

**Mr. Shreebhadra Khanal** in his thesis titled "Public Debt in Nepal" concludes the public debt as a monetary measures and it is a weapon in hands of the Central Bank to regulate the economy so that the inflation generated in the process of economic growth may not be followed by hyper inflation. Mr. Khanal further says that the least developed and underdeveloped countries should form quite effective and strong fiscal policy so that domestic saving would be maximized and it can be used for capital formation and on nation's well being turn. The fund may be gained either from effective and progressive taxation or from borrowing.

In 1974/75, the internal debt of government was amounting Rs. 412 million. The internal debt in 1984/85 has increased to Rs. 7706 million. The growth of public debt and the burden of debt servicing liability, it imposes is a matter of serious concern. This is so especially because the public sectors 'need' for large net borrowing is likely to continue, given the overall trends in the public sector's financial operations. The total

debt in 1974/75 (internal and external debt) was Rs. 758 million which reached to Rs. 16909 million in 1987/1988. Therefore, the debt has been increasing from is being till now due to recoup deficit budget in Nepal. (Economy Survey, MOF and NRB)

**C. Rhee (2005)** has discussed on his article 'Public Debt management Policy in Nepal' covering the various aspects of public debt management policy adopted by Nepal with recommendations for sustainability of public debts in a country like Nepal. The report discussed the importance of public debt management along with the practical principles. It analyzes the concept of optimal benchmark portfolio concept as an indicator of sustainable debt management tool. It highlights the activities for debt management into three categories namely - Resource mobilization, Debt and risk analysis and Management information system and settlement.

**Dr. R.S. Mahat** in his classic venture 'Capital Market, Financial Flows and Industrial finance in Nepal' has asserted that the Government has the virtual monopoly over the security market. The resort of security market by the government has been only in the form of borrowing mainly through the issuance of development bonds to meet the budgetary expenses. The first series of development bond were floated on February 12, 1964. It carried 6 percent rate of interest and had the maturity period of five years. Since then, the government has been floating the development bonds each year. Till 1981, it had floated fourteen issues of such bonds carrying the interest rate ranging from 5 percent to 10 percent and with maturity period varying from the five years to ten years. The magnitude of funds raised through this method also has been rising each year. The total bonds issued during the fiscal year 1965/66 amounted to Rs.705 million. In 1970/71, it was equivalent to Rs. 30

million and it reached Rs. 300 million in 1976/77. The growth has been in absolute as well as relative term (Mahat, 1981:25).

### **2.6.2 Review of thesis**

**Mr. R.D. Singh (1983)** has prepared a dissertation entitled “A study on the impact of internal borrowing in Nepal” (1983) has analyzed the trend of revenue, expenditure and deficit and effect of under borrowing on money supply, inflation and import. He also analyzed the structure of internal public debt and impact of it on the economy. He found most inflationary nature of internal borrowing to increase inflation in the economy. *(Singh, 1983)*

**Mr. Hari Krishna Koirala (1997)** suggests that borrowing internally is better than borrowing externally. The internal borrowing mobilization for the development purpose has also been fluctuating and the banking sector has dominated the total internal borrowing. Government should have to initiate policies to attract maximum borrowing from non-banking sector. It is the most non-inflationary source of internal borrowing since it is simply transfer of idle saving from people to government from development purpose. *(Koirala, 1997),*

**Mr. Vijru Prasad Sharma (1998)** in his dissertation paper titled “Public Debt” in 1998 has debt on the positive role of public borrowing for the sound economic growth and prosperity. He also suggested that the state should not disburse the debt unproductively. The rich people can get more benefit from public debt due to increasing trend in the issue of public debt. He clearly says-the interest rate and its development are the major benefit from the public debt. But if there increase in small saving, ownership of debt is defused and the problem of inequality in the distribution of wealth and income minimized. *(Sharma, 1998)*

**Mr. Daya Ram Sharma (2001)** in his thesis titled “Public Debt: System and Practices in Nepal” focused in the positive aspects of public debt. “It itself is neither the worse not it impairs the economy. He has focused public borrowing in the country for budgetary aspects but for maintaining smooth and sound economy. He further emphasizes public debt is the quite beneficial for the nation as it outstrips the national economy as a whole. (*Sharma, 2001*).

He has also focused bad aspects of borrowing in the country, which are presented below:

- ❖ Government borrows the loan according to its whim and indulgence
- ❖ It pours the whole amount of borrowing on non-productive sectors.

Thus, the borrowing from people can be considered important if generated funds are honestly used as education, health and other development functions.

Every year, Government has been borrowing huge amount of money from public by issuing Government bonds to finance deficit budgetary system of Nepal. The External debt threats for the economy but internal debt is considered good because it transfers money from one person to another person within country. Therefore, the internal debt is somewhat better External debt.

**Mr. Ram Prasad Poudel (2002)** in his thesis "A study on government security practice in Nepal" studies the specific objectives are: (I) To analyze the trend and structure of government bond in Nepal (II) To examine the attitude of the investors towards the government securities (III) To overview GON bonds issue system and practices (IV) To suggest the policy and procedures to reform debt management of Nepal. He

concluded that Nepalese investors are attracted towards government securities in comparison to other investment sectors. Most of the investors of Nepal are risk averter and they seek less risky investment. Different people are participating in government securities such as rich, poor, educated, uneducated etc. *(Poudel, 2002.)*

**Ms. Suniti Sharma (2006)** in her dissertation paper titled "An Analysis of Internal Borrowing and Government Security Market in Nepal" studies the public borrowing situation in Nepal. Her analysis about the trend and structure of government bond in Nepal examine the attitude of the investors towards the government securities. She has concluded that the public borrowing is growing rapidly with domestic and external borrowing. She emphasized the requirement of institutional reforms in public debt management to win the confidence of the public and expanding the range of public bond subscribers. The subscription of debt depends on the environment confidence in political, social and economic sphere through the formation of disciplined, accountable and efficient government institution. *(Sharma, 2006).*



## **Chapter-3**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

Research is to find out to gain knowledge about a phenomenon. The research methodology describes that methods and process applied in the entire aspect of study. Research methodology is a way for systematically solving the research problems. In other works, research methodology indicates the method and processes employed in the entire aspects of the study. “Research methodology refers to various sequential steps (along with rational of each such steps) to be adopted by a researcher in studying a problem with certain object/objects in view.” (Kothari,1994). So it is the methods, steps and guidelines, which are to be followed in analysis, it is way presenting the collected data with meaningful analysis.

#### **3.2 Research Design**

Research design is the plan, structure and strategy of investigation conceived so as to obtain answer to research questions and to control variance. (Kerlinger, 2002). This research design is a plan to obtain the answer of the research question through analysis of data. It is the specification of methods and procedures for acquiring the information needed.

This study is primarily based on secondary data and descriptive, analytical as well as quantitative approaches are developed to examine the issues. The primary data has been collected to examine the investor’s attitude toward government securities. The study is an examination and evaluation on the deficit budgetary policies as incorporated in the budget documents. The government has been borrowing huge money to recover deficit budgetary system of Nepal. The data, information and policies extracted from the budget documents and economic bulletin from NRB

have been presented in meaningful order. Different statistical models such as second degree of trend and other model have been applied to interpret the data and to come into conclusion.

### **3.3 Population and sample**

In order to show the trend and structure of government debt in Nepal, 21 year data (F.Y. 1987/88 to 2008/09) have been taken into account and the sample will not be more than 200 for chi-square ( $X^2$ ) test of hypothesis. This is because we are interested to examine investor's attitude towards government securities.

### **3.4 Sources of Data and Information**

The study is based on secondary data as well as primary data. The major sources of secondary data are magazines, website and official publications, annual report of the Nepal Rastra Bank and Ministry of Finance. Some other sources of secondary data are published data by National Planning Commission, Central Bureau of Statistics, and Center for Economic Development and Administration (CEDA), Security Board of Nepal and others concern Newspaper, Publication and Website.

The questionnaires were distributed to 200 hundred respondents and among of this only 145 respondent had responded.

#### **3.4.1 Questionnaire for $X^2$ (Chi-Square) Test of Hypothesis, Analysis and Interpretation**

This study is based on the secondary data collection as stated above "in sources of data and information". The primary data has been collected by Administrating questionnaire and conducting interviews processing of data has been done in computer using application programs like Ms-excel etc. The Chi-square test of hypothesis will be useful to examine the interest and awareness of Nepalese people on government securities. The

samples will be taken to fulfill this objective from various backgrounds: a group of educated people, a group of people with different annual incomes, positions on various jobs, and a group of people from different location etc. The questionnaire will be prepared to achieve objective and entire data will be collected from primary source.

### **3.4.2 Research Variables**

A variable is a symbol to which numerals or values are assigned. (*Ibid-p-300*). So the variables can take on values. Total expenditures (Regular expenditure and development expenses), sources of financing and sources of financing deficit are the research variables of this study. Thus this study is based on primary and secondary data. Primary data are collected for the analysis of investor's attitude. Samples are used for primary data collection from different backgrounds. The secondary data are collected from above mentioned sources.

### **Data Collection Instrument**

This study is mainly based on secondary data. Besides, a detailed review of literature has been conducted in order to collect relevant data and information. The review materials are mainly collected from central library of T.U., Kirtipur, Library of Shanker Dev Campus and others public libraries. Apart from this, some useful data, facts and figures are also obtained from investors and experts.

### **3.5 Data Analysis Tools**

The data collected from various sources leads to the logical conclusion, only if the appropriate tools and techniques are adopted to analysis such data. The collected data has no meaning if such data are not analyzed. The collected data will be analyzed with the help of statistical and financial tools. The statistical and financial tools like average (mean), coefficient of variation, percentage, etc. will be applied in analysis and

interpretation. Presentation will be made in the form of tables, graphs, chart and figures.

### **3.5.1 Financial Tools**

These tools will focus on proportion analysis of internal debt with total internal debt. By the help of tool, the researcher also studies the composition of government debt.

### **3.5.2 Statistical Tools**

Statistical tools are the instrument to analyze the collected data from different sources. In statistics, there are numerous statistical tools to analyze data of various natures. In this study, the researcher has used the following statistical tools.

#### **(A) Trend Analysis**

Trend analysis is a significant tool of horizontal financial analysis. Trend analysis help to identify the controllable items of given period and future can be made for ongoing concern. It is one of the useful tools in making a comparative study of the financial statement of the number of years. Under this topic, trend of total internal debt is forecasted for next 7 years. To forecast the total internal debt for next years, the researcher has been used second degree (parabolic) trend.

#### **(B) Chi-square ( $X^2$ ) Test**

The interest and awareness of the investors or attitude of investors toward government securities has been studied with the help of these tools. Besides these tools, the researcher has also used others tools like Average, standard deviation and coefficient of variation to analyze and interpretation of data.

## **CHAPTER-4**

### **DATA PRESENTATION AND ANALYSIS**

This chapter deals with the presentation, analysis and interpretation of statistical data carryout the research work. Here, the study presents the collected data for various purpose of analysis. The data are analyzed by using various statistical and financial tools. The analyzed data and results are presented in each topics and subtopics. This chapter includes four subchapters, they are following:

- a) trend and structure of government securities in Nepal
- b) Attitude of Investors toward the government securities
- c) The system and practices of government securities in Nepal.
- d) Major findings of the study

#### **4.1 Trend and Structure of Government Securities in Nepal**

##### **4.1.1 Introduction**

Government securities are the fixed income securities issued by the government. These securities are among the safest of all investments, as the government is unlikely to default on interest or on principal repayments.

SECURITIES MARKET IS A MECHANISM created to facilitate the exchange of financial securities or assets by bringing together buyers and sellers of securities (Sharpe 1998). Securities markets provide an effective way of procuring long-term funds by issuing shares and debentures or bonds for corporate enterprises and government and at the same time provide an investment opportunity for individuals and institutions (Adhikari 2004). Thus, the market place for these financial securities is called securities market which is further subdivided into the

primary and secondary market. The former market denotes the market for newly issued securities to the public whereas the latter market refers to the market for secondhand securities, traded previously in the primary market (Francis, 1991). The securities market plays an important role in mobilizing savings, and channeling them into productive investment for the development of commerce and industry of the country. It basically assists the capital formation and economic growth of the country.

In many developing countries like Nepal, the undeveloped capital market is still prevailing in the economy. The Nepalese securities market still could not take its height. The further improvement of this market is very crucial. It helps in accumulating even small savings for development activities of the economy otherwise, which would have spent in unproductive areas. But it is true that there is no presence even of organized money market in rural areas, which covers almost 90 percent of the total area of the country. Thus, the securities market is only confined to the very limited urban areas of Nepal. Despite these truths, an attempt has been made to analyze the growth trends and performance of Nepalese securities market.

Securities market plays a pivotal role in mobilizing savings and channeling them in productive purposes and many more like providing liquidity on securities so that one can minimize the risk and maximize the returns. The study on the securities market performance reveals that there is no synchronization among different securities market performance indicators, but it is true that they almost have depicted an erratic trend during the observed period. This indicates the unstable and poor performance of securities market. Relative to the overall economy, the size of securities market is very small and the liquidity of securities also is poor. These facts suggest that the Nepalese capital market now is passing through a bearish situation. The growth and performance of

Nepalese securities market, even after the introduction of new mechanism in 1993/94, are not satisfactory though it is improving gradually.

The government of Nepal has been raising public security since the first budget speech of Nepal. The first part of this chapter covered the term and structure of government security where as its performance is carried in detail in this chapter. Here the analysis is made on the basic of amount raised in term of treasury bills, national saving bonds, special bonds and citizen saving certificates. Overdraft is also taken as internal debt for the analysis of the structure of the debt.

Internal security is interrelated with the basic government fiscal flows of revenue and expenditures. If the volume of the government expenditure exceed the volume of government revenue, fundamental precondition for creating public debt. Debt creation should be viewed as one of several alternatives financial managements. And "debt is merely a means of meeting a particular budgetary situation, namely a deficit budget caused by excess of government spending over receipt. *(Herber, 1988)*

Internal borrowing is one of the appropriate sources of public borrowings. It is applied as means of mobilizing internal resources in the development process of the country in a wider prospective. The collected funds through public debt should be used in the social welfare sectors, like as; to develop infrastructure, to build school, hospital, drinking water etc. These are the main principal of public debt. Because of these sectors, private investors are not willing to invest due to lack of sufficient return in short term however these are the very important for the people. During the period of world war, the government of concerned countries borrowed a large amount of money to meet its expenditures. "Public borrowing policy helped to transfer the ownership of resources to the

hands of government from the hands of people scattering all over the country" (*Joshi 1982*). In the "Investment Strategy in Nepal; published by the World Bank, it is suggested to keep the internal debt within 2 percent of GDP of the nations. (*Upreti, 1999 : 117*). Government borrows the amount that equal to the gap between aggregate expenditure and current revenue.

The expenditure and revenue generation are not same pace in Nepalese economy so, Nepal has been suffering from shortage of capital since the first budget speech. The main sources of revenue generation are custom duty, tax and internal sources. Due to the frequently changes in political situation, the government has not been able to implement efficient and effective policy to collect revenues in Nepal.

Generally, securities are issued for following reasons:

- a) To recover the deficit budget.
- b) To maintain the welfare state and economic development
- c) To maintain peace and law and order
- d) To maintain economic and monetary stability.

#### **4.1.2 Trend of Government Securities Issued in Nepal**

Every year, the government has adopted a deficit budgetary system in the name of development functions. The government of Nepal has been issuing four types of securities. Therefore, government issues various bonds to recover the deficit budget of Nepal. The treasury bills, development bonds, national saving bonds, special bonds, citizen saving certificates and overdraft are the debt-borrowing instrument in Nepal. Now, there are treasuries bills, development bonds, national saving certificates and special bonds are the main sources of internal borrowing. The types and amount of government securities under the review period 1987-2008 is tabulated below.



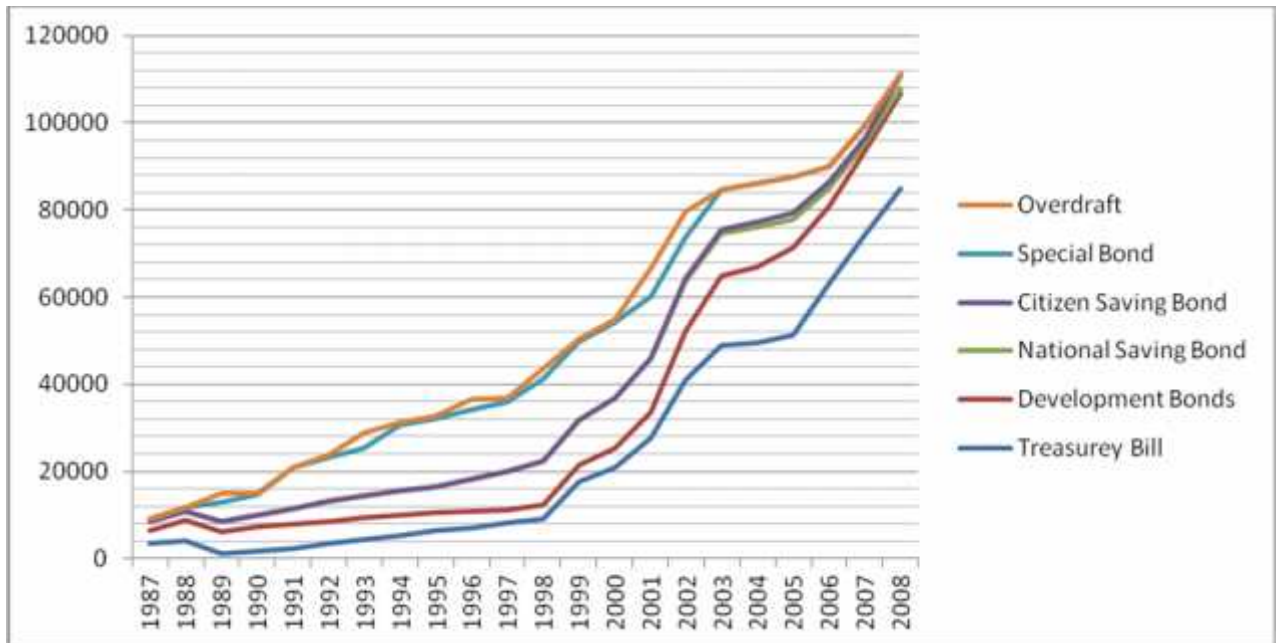
**Table 4.1.1 Trend and Amount of Government Securities Issued in  
Nepal (1987-2008)**

**Rs in millions**

<b>Year</b>	<b>Treasury Bills (a)</b>	<b>Development Bonds (b)</b>	<b>National Saving bonds (c)</b>	<b>Citizen Saving Certificates (d)</b>	<b>Special Bonds (e)</b>	<b>Overdraft (f)</b>	<b>Total Internal Debt (a+b+c+d+e+f)</b>
1987	3440.0	2990.0	1940.0	0.0	627.4	44.7	9042.1
1988	4090.0	4651.7	2196.5	0.0	697.8	0.0	11636.0
1989	1171.0	5088.6	2196.5	0.0	4431.8	2041.2	14929.1
1990	1821.0	5388.6	2896.5	0.0	4567.0	406.1	15079.2
1991	2351.0	5482.3	3646.5	0.0	9376.1	0.0	20855.9
1992	3483.2	5132.2	4546.3	0.0	10073.2	622.3	23857.2
1993	4403.2	5132.2	4901.5	0.0	11019.1	3274.3	28730.3
1994	5216.3	4732.2	5691.5	0.0	14991.2	684.7	31315.9
1995	6392.5	4122.2	6076.4	0.0	15466.8	743.0	32800.9
1996	7142.5	3672.2	7376.5	0.0	16050.6	2288.3	36530.1
1997	8092.5	3042.2	8736.5	0.0	16019.6	949.1	36839.9
1998	9182.5	3302.2	9886.4	0.0	19035.5	2224.0	43630.6
1999	17586.9	3872.2	10426.4	0.0	17784.2	842.3	50512.0
2000	21026.9	4262.2	11526.5	0.0	17541.4	522.7	54879.7
2001	27610.8	5962.2	12476.4	0.0	13994.3	6546.7	66590.5
2002	41106.6	11090.7	11536.3	628.1	9259.4	5897.2	79518.3
2003	48860.7	16059.2	9629.8	931.1	9164.5	0.0	84645.3
2004	49429.6	17549.2	9029.8	1178.9	8946.2	0.0	86133.7
2005	51383.1	19999.2	6576.8	1429.9	8176.3	0.0	87565.3
2006	62970.3	17959.2	3876.8	1678.9	3469.8	0.0	89954.9
2007	74445.3	19177.1	1516.9	1391.0	2773.5	0.0	99303.8
2008	85033.0	21735.4	1116.9	3014.4	339.4	0.0	111239.1

**Source:** Quarterly Economic Bulletin, Nepal Rastra Bank (from 2000 to Mid January 2008)

**Figure No 4.1.1**



In the above table, the net outstanding internal public debt has been presented in its terms of types such as treasury bills, development bonds, national saving bonds, citizen saving certificate, special bonds and overdraft. This study has covered overdraft also for the analysis of the total internal public debt.

The five types of government securities are not insignificant. Government has been collecting huge amount by issuing these securities. Treasury bills are short term loan. They are issued for the period of less than one year. Treasury bills are normally floated for the period of 91 days however; sometimes government issues bills for 365 days. Development bonds, national saving bond, citizen saving certificates and special bonds are the long term government securities. In the above table, treasury bills in 1987 is Rs. 3440.0 million which trend is growing and reached to Rs. 85033.0 million in 2008. The government has been collection large amount of internal debt from treasury bills. The loan has been growing sharply from 1987 to 2008.

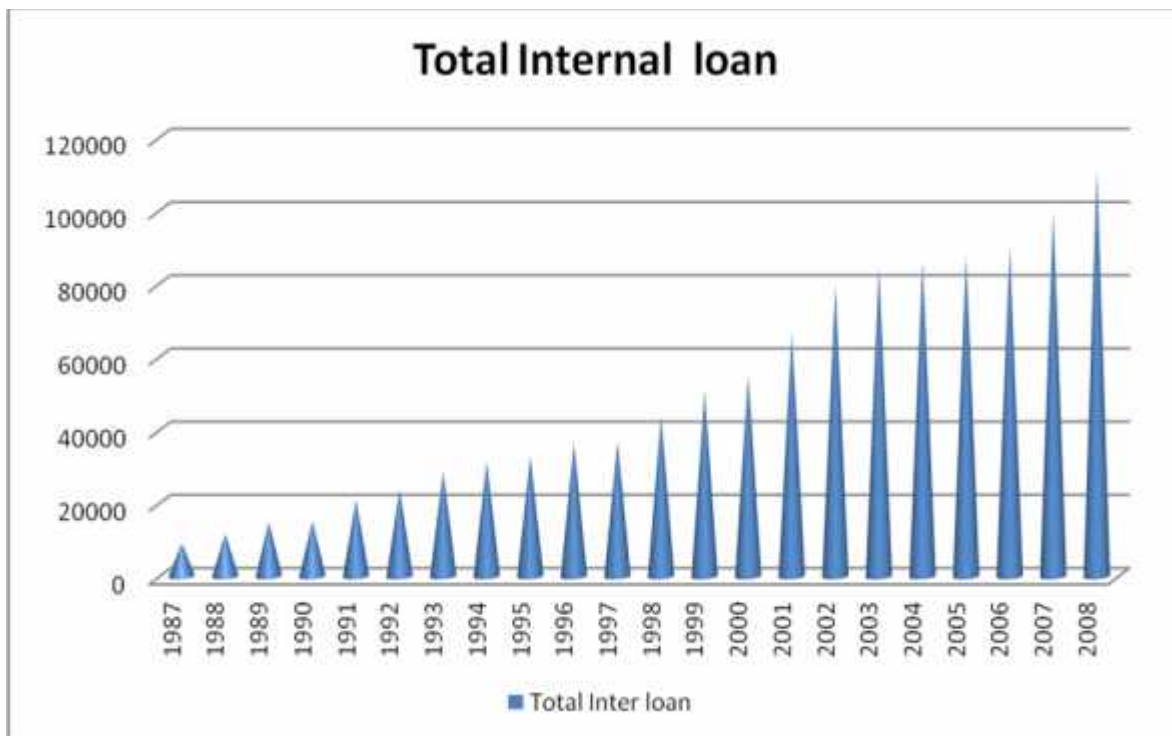
Similarly, the development bonds have also increased from 1987-2008. The total bond issued is Rs. 2990.0 million in 1987 and Rs. 21735.4 million in the years 2008. Such bonds have not increased in comparison to treasury bills. The trend shows fluctuating during the period of 21 years. Every week, government has been selling huge amount of treasury bills in the market. Most of the individual and institutional investors purchase short-term securities. It may be due to maturity of short period.

The national saving bonds have been growing in the year from 1987 to 2001. But in the year from 2001 to 2008, the bonds have been decreasing. The government has been gradually increasing funds by issuing national saving bonds since the year 1987 to 2001. Saving bonds have been decreasing from the period of 2001 to 2008. In the national saving bonds are 11536.3 million, and 1116.9 millions on 2002, 2008 respectively. The citizen saving certificate have been listed in zero in above table from 1987 to 2001. It has been issuing from the year 2002. The issue trend of citizen saving certificate have been decreasing since the first issue. In the year 2002 the government has issued in 628.1 million and Rs. 3014.4 million in the year 2008.

In the case of special bonds, the trend is same as in the case of other types of internal debt. It is also in fluctuating trend. But the overdraft is not like others government securities. It is loan for government from five NRB. From 2003 to 2008, table shows the overdraft at 0.0, which means that the government has surplus funds in NRB account. Thus the above table shows debt policy of Nepalese government. The government of Nepal has been borrowing huge amount by issuing various government securities at different times. The various securities are issued for the purpose of fulfilling varieties of problems of the country. The trend of the

treasury bills, development bonds, national saving bonds, citizen saving bonds, special bonds and overdraft is fluctuating. But the trend of total internal debt is upward slopping. The above curve clearly shows the debt collection policy of Nepal government. The government has been selling the five types of securities. They are issued to recover the deficit budget of Nepal. It clears in more details by following diagram.

**Figure no 4.1.2**



## **4.2 ATTITUDE OF INVESTORS TOWARDS THE GOVERNMENT SECURITIES**

### **4.2.1 Introduction**

The analyst may judge the simple approximation instead of the result of test of goodness of fit, test of independence, and test of homogeneity but unless and until it is proved statistically it can not be certified as an authentic accreditation. This study has attempted the sample survey among the security holders and concerned other requiring their respective interest, comments, grievances, and awareness on government

securities. 146 sample sizes were taken which were scattered at most, among the various categories of people in regards to their income, residence, profession, awareness, etc. There were 16 questionnaires, requested to fill up to test the investors' attitude towards government securities.

The public debt department of NRB, civil servants of Ministry of Finance has put their view in favor of public borrowing as the popular investment. On the other hand, the private stockholders who were dealing highly marketable stocks at Nepal Stock Exchange argued the government securities are created for those who are attracted to invest in the risk less investor. They pointed that only the risk-averter investors invest in the government securities. As the issue is closely related to economics and finance and due to the fact that government security is beyond the reach of the common people naturally they did not want to go into the depth and refused to answer in detail. On the matter of government security they were indifferent.

This study has considered various income groups, various professions of investors, various geographical areas and so on. The test has tried to find out whether the awareness of investors on government securities is dependent upon their respective profession, income or not.

Some investors invest on government securities as they consider it more beneficial and secured. They have expressed their satisfaction on such investments. They do not sell the bonds until they need cash for some sort urgent need. In brief they are entirely satisfied as investors on government security. They have no particular grievances against the procedure of debt financing management. Similarly, some investors invest on government securities as they cannot find other sound investment opportunity. Besides they understand that the government

security is more secured than other. In fact, the attitude towards the government bonds is not so satisfactory. They sell government bond if they find the good investment opportunity in the market.

Some investors invest on government security because of its financial return, marketability, maturity, etc. they are very watchful about whether the amount they lent to the government is utilized properly or not. It is natural because they lend the money at low rate of interest so that they may also contribute to the nation according to ability and status. They sell the government security when they require fund or when they are psychologically dissatisfied with the government security. Likewise they sell the bonds if more beneficial opportunity appears in the market.

#### **4.2.2 Analysis of Questionnaire Survey:**

A questionnaire was prepared to evaluate the attitude in investors on government securities in Nepal. There were 16 questions (See Appendix 9) and 16 respondent included in analysis. The respondents were service holders, university student's businessman, brokers and others. The attitudes of investors are explained below the basis of collected sample.

- **Investors' Classification:**

Investors investing in government securities are classified into two types: Institutional Investors and Individual Investors. Out of the total 145 respondents, 43.21 percent belonged to individual investors' group and 19.5 percent are institutional investors while 27.5 percent felt to both the groups and rest are non-investors.

**Table No: 4.2.1**

<b>Investor</b>	<b>% of Investor</b>	<b>No. of Investor</b>
Institutional Investors	19.5	28
Individual Investors	43.21	63
Both the groups	27.5	39
Non-Investors	9.79	15
<b>Total</b>	<b>100</b>	<b>145</b>

• **Subscription of Government Securities:**

In response to the question of the types of Government Securities that are highly subscribed in the market, a very high majority of 100 respondents (or 69.33%) felt that it is Treasury Bills, 23.9% responded it to be Development Bonds and rest response it to be National Saving Bonds. None of the respondents thought that Special Bonds and Citizen Saving Certificate are the types of Government securities that are subscribed in the market. Types of Government Securities that are highly subscribed in the market

**Table No: 4.2.2**

<b>Types Of Government Securities</b>	<b>No of investment</b>	<b>% of Investor</b>
Treasury Bills	100	69.33
Development Bonds	35	23.9
National Saving Bonds	10	6.77
Special Bonds	-	-
Citizen Saving Certificate	-	-
<b>Total</b>	<b>145</b>	<b>100</b>

• **Time to Know about Government Securities:**

In response to the question of time since they have known about Government securities, a majority of 55 percent respondents felt that they knew about the Government securities only a few years before, 19.3

percent respondents felt that they know about it after the restoration of democracy in 1990, 17.7 percent know about it recently and 4.7 percent know about it at the time of the first budget speech in Nepal while 3.3 percent know at other times.

**Table No: 4.2.3**

<b>Time of known</b>	<b>% of Investor</b>	<b>No of Investor</b>
Recently	17.7	25
A few years before	55	80
After the restoration of democracy in 1990	19.3	28
At the time of the first budget speech	4.7	7
Other times	3.3	5
<b>Total</b>	<b>100</b>	<b>145</b>

- **Source to Know about Government Securities:**

When the 145 respondents are responded on how they came to know about government securities, 51.63 percentage felt that they came to know about government securities through papers and government notices, 23.52 percentages know from friends, 15.3 percentage knew as they were staff of banks, 6.67 percentage came to know from government notices and employees circle as they themselves are government employees, and the rest 2.88 came to know through other media, like teachers, books, etc.

**Table No: 4.2.4**

<b>Sources</b>	<b>No of Investor</b>	<b>% of Investor</b>
Through papers and government notices	75	51.63
From friends	34	23.52
From staff of banks	22	15.3
From government notices and employees	10	6.67
Media, like teachers, books	4	2.88
<b>Total</b>	<b>145</b>	<b>100</b>



- **Condition to Induce on Government Securities:**

In response to the question of the conditions that induce the investors to invest in Government Securities, 59.1 percent respondent that tax-free and collateral securities induce the investors in invest in government securities. 26.14 percent respondents has their opinion that only tax-free conditions would be enough for the inductions, while 7.38 percent thought only collateral conditions would perform the task. The rest 7.38 respondents thought there are other conditions that induce the investors to investment.

**Table No: 4.2.5**

<b>Condition to induce</b>	<b>% of Investor</b>	<b>No of Investor</b>
Tax-free and collateral securities induce	59.1	85
Only tax-free conditions	26.14	38
Only collateral conditions	7.38	11
Other conditions	7.38	11
<b>Total</b>	<b>100</b>	<b>145</b>

- **Reason for Investment in Government Securities:**

In response to the question of the reason for the investment in government securities, 81.54 percent respondents responded that investment in government securities is risk-less. 5.42 percent thought the zero liquidity risk is the reason while the other 4.31 percent thought that the declining interest rate in other investment sectors (i.e. the interest rate on saving account) is the reason. A minority of 1.87 percent respondents thought that the lack of other corporate securities is lending to the investment in government securities. Only 6.86 percent people responded that they have not idea.

**Table No: 4.2.6**

<b>Reason for Investment</b>	<b>% of Investor</b>	<b>No of Investor</b>
Because of risk-less	81.54	118
Because of zero liquidity risk	5.42	8
Declining interest rate	4.31	6
Lack of other corporate securities was lending to the investment in government securities	1.87	3
Not idea	6.86	10
<b>Total</b>	<b>100</b>	<b>145</b>

- **Possibility of Default Risk in Government Securities:**

The respondents about the possibility of default risk on the investment on Government Securities in terms of annual interest payment and principal at maturity. 64.8 percent felt there is no risk and 29.5 percent responded that there is some risk while only 3.4 percent reported that there is a high risk 2.3 percent person has no idea.

**Table No: 4.2.7**

<b>Possibility of Default Risk</b>	<b>% of Investor</b>	<b>No of Investor</b>
No risk	64.8	94
Some risk	29.5	43
High risk	3.4	5
No idea	2.3	3
<b>Total</b>	<b>100</b>	<b>145</b>

- **Risk on Interest and Principal at Maturity:**

The feeling of security about the investment in Government Securities is very important. All the respondents responded about how secured they felt about their investment in the Government Securities. They study showed that most of the investors are very much secured about such an investment as 81.25 percent respondents reported that they are 100%

secured to get the interest and principal. 11.4 percent reported that they are 100% secured to get the principal only and only 7.4 percent felt unsecured.

**Table No: 4.2.8**

<b>Risk on Interest and Principal</b>	<b>% of Investor</b>	<b>No of Investor</b>
100% secured to get the interest and principal	81.25	118
100% secured to get the principal only	11.4	16
felt unsecured	7.4	11
<b>Total</b>	<b>100</b>	<b>145</b>

- **Security of Interest and Principal:**

Collecting interest and principal of the investment should be an easy process. All the respondents responded about the difficulties in collecting interest and principal of the investment. A majority of 55.7 percent respondents reported that it was difficult due to the behavior of the officials, 44.3 percent reported that there was no difficulty.

**Table No: 4.2.9**

<b>Security of Interest and Principal</b>	<b>% of Investor</b>	<b>No of Investor</b>
Difficult due to the behavior of the officials	55.7	81
No difficulty	44.3	64
<b>Total</b>	<b>100</b>	<b>145</b>

- **Reason to sell the Government Securities:**

The respondents reported about the reasons that make them sell the Government Securities. A majority of the respondents (62.48%) said that they sell the Government Securities to grab alternative investment opportunity (i.e. to invest on shares issued by the reputed private companies), 15.1 percent respondents said they sold them to benefit from investment in real asset (tangible assets). 13.36 percent respondents reported that they sold the Government securities to meet

their household requirements and rest (13 respondents) sold them when the stock is overprices.

**Table No: 4.2.10**

<b>Reason to sell the Government Securities</b>	<b>% of Investor</b>	<b>No of Investor</b>
To grab alternative investment opportunity	62.48%	91
To benefit from investment in real asset	15.1	22
To meet their household requirements	13.36	19
Sold them when the stock is overprices	9.06	13
<b>Total</b>	<b>100</b>	<b>145</b>

- **Uncertainty on Investment in Government Securities:**

In response to the question about when the respondents felt uncertain about investment on Government Securities, a majority of 44.32 respondents reported that the lack of consideration of time value of money made them fell uncertain and 56.14 percent felt that the complex rules and regulations to be followed a the time of making

**Table No: 4.2.11**

<b>Uncertainty on Investment in Government Securities</b>	<b>% of Investor</b>	<b>No of Investor</b>
Due to consideration of time value of money	44.32	64
complex rules and regulations to be followed	56.14	81
<b>Total</b>	<b>100</b>	<b>145</b>

- **Buyers on Government Securities:**

Out of the total 145 respondents, 48(33.25 percent ) reported that the buyers of securities were financial institutions, 39(26.7 percent) responded they were service holders, 32 (21.86 percent) felt they were business firms, 24 (16.48 percent) responded them to be retired people and the rest 2 (1.7 percent) had no idea.

**Table No: 4.2.12**

<b>Buyers on Government Securities</b>	<b>% of Investor</b>	<b>No of Investor</b>
Financial institutions	33.25	48
Service holders	26.7	39
Business firms	21.86	32
Retired people	16.48	24
Rest	1.7	2
<b>Total</b>	<b>100</b>	<b>145</b>

- **Source of Income to Invest in government Securities:**

The respondents responded about the income source they used to purchase the Government Securities. A large 69.9 percent respondent reported that they used idle cash, 12.5 percent used residual amount, 7.4 percent used profit from business, 5.7 percent used sale of fixed assets and the remaining 4.5 percent took loan in order to purchase the Government Securities.

**Table No: 4.2.13**

<b>Source of Income to Invest</b>	<b>% of Investor</b>	<b>No of Investor</b>
Idle cash	69.9	101
Residual amount	12.5	18
Profit from business	7.4	11
Sale of fixed assets	5.7	8
Took loan	4.5	7
<b>Total</b>	<b>100</b>	<b>145</b>

- **Subscription of Government Securities:**

There are some good reasons for the full subscription of Government Securities: the good marketing policy of NRB, the influence from intimate partners, good investment sector from risk and return perspective, and the lack of information of other investment sector. The respondents were

questioned about the order of priority of these reasons. Though there was a lot of variation in setting the priority of the reasons, most of the respondents set a greater priority to the lack of information of order investment sector.

- **Use of Government Borrowing:**

The Government of Nepal has been collecting huge amount of money from people. The respondents answered about their opinion about the productive use of the collected amount 62 (42.64%) respondents were of the opinion that the collected money was productively used. It was found that most of the respondents were service holders. 36 (24.84%) respondents reported that amount had been unproductively used and 33 (22.86%) thought that it misused. It was found that most of these respondents were students who thought that the money collected was either misused or unproductively used. The remaining 14 (9.66%) reported that they do not have any idea in matter. Rather they were of the opinion that the collected money had used in some productive sector.

**Table No: 4.2.14**

<b>Use of Government Borrowing</b>	<b>% of Investor</b>	<b>No of Investor</b>
Productively used	62	42.64
Unproductively used	36	24.84
Misused	33	22.86
Do not have any idea	14	9.66
<b>Total</b>	<b>145</b>	<b>100</b>

**Test of Hypothesis:**

Non parametric test i.e. chi-square ( $\chi^2$ ) is used to find out the interest and awareness of Nepalese people towards the government securities. Five tests have been done based on the various categories of the sample i.e. educational background, profession, residence, annual income

education etc. Basically, the tests are adopted by thinking that the samples can represent the attitude of Nepalese people towards the government securities. It is assumed that the people may have different attitude towards the government securities i.e. they may be more interested, less interested more aware, less aware to government securities. It is also assumed that their education, profession, educational background, residence and their annual income affect these attitudes. Here, these attitudes and the effect of various categories are tested by adopting the chi-square ( $\chi^2$ ) test of hypothesis.

### **Test - I**

It is said that the interest of people will be affected by their profession, i.e. who have not enough time to seek the profitable stock and haven't time to take the opportunities of market, are more interested to purchase the government securities, and who have enough time to seek the profitable stock, are less interested to purchase the government securities i.e. the civil servant and permanent employee of organized bodies have no time to seek the profitable stock and to take the opportunities of the market so they are more interested to purchase the government securities but businessman, student & retired persons have the enough time to seek the profitable stock and to take the opportunities of the market. So they are less interested to purchase the government securities.

The randomly selected samples of people are classified according to their profession. Here it is tested that whether the profession affects their interest towards the government securities or not.

**Table 4.3.1**

**4.3.1 Hypothesis Test for Investor Attitude on Government Securities in Terms of their Occupation**

Attitude	Profession			Total
	Business man	Civil Servant & Permanent Employees of Organization	Students, retired person and others	
More Interested	15	48	9	72
Less Interested	35	22	16	73
<b>Total</b>	<b>50</b>	<b>70</b>	<b>25</b>	<b>145</b>

**Formulation of Hypothesis:**

**Null Hypothesis (Ho):** The investor's attitude to invest on government securities is independent on their occupation. In other words the attitudes of Nepalese people are not affected by their profession i.e. all professional people are equally interested to purchase the government securities.

**Alternative hypothesis (H<sub>1</sub>):** The attitude of Nepalese people are affected by their profession i.e. the business man, student and retired person are less interested to purchase the government securities, where civil servant of government of Nepal, permanent employee of organized bodies are more interested to purchase the government security.

**Fixing the Level of Significance:**

The level of significance ( $\alpha$ ) = 5%

**Calculation of Expected Frequencies:**

Expected Frequency of R<sub>1</sub>C<sub>1</sub> (15)

$$= \frac{\text{Row Total} \times \text{Column Total}}{\text{Grand Total}} = \frac{72 \times 50}{145} = 24.83$$

$$\frac{\text{Grand Total}}{145}$$

Expected Frequency of R<sub>2</sub>C<sub>1</sub> (35)



$$= \frac{\text{Row Total} \times \text{Column Total}}{\text{Grand Total}} = \frac{73 \times 50}{145} = 25.17$$

Expected Frequency of R<sub>1</sub>C<sub>2</sub> (48)

$$= \frac{\text{Row Total} \times \text{Column Total}}{\text{Grand Total}} = \frac{72 \times 70}{145} = 34.76$$

Expected Frequency of R<sub>2</sub>C<sub>2</sub> (22)

$$= \frac{\text{Row Total} \times \text{Column Total}}{\text{Grand Total}} = \frac{73 \times 70}{145} = 35.24$$

Expected Frequency of R<sub>1</sub>C<sub>3</sub> (9)

$$= \frac{\text{Row Total} \times \text{Column Total}}{\text{Grand Total}} = \frac{72 \times 25}{145} = 12.41$$

Expected Frequency of R<sub>2</sub>C<sub>3</sub> (16)

$$= \frac{\text{Row Total} \times \text{Column Total}}{\text{Grand Total}} = \frac{73 \times 25}{145} = 12.59$$

**Table No 4.3.2**

**Calculation of Chi-Square (x<sup>2</sup>)**

Observed Frequency	Expected Frequency (E)	(O-E)	(O-E) <sup>2</sup>	(O-E) <sup>2</sup> / E
15	24.83	-9.83	96.63	3.89
35	25.17	9.83	96.63	3.84
48	34.76	13.24	175.30	5.04
22	35.24	-13.24	175.30	4.97
9	12.41	-3.41	11.63	0.94
16	12.59	3.41	11.63	0.92
<b>Total</b>				<b>19.6</b>

**Test Statistics**

$$\text{Chi Square (x}^2\text{)} = \sum \frac{(O - E)^2}{E}$$

$$= 19.6$$

Calculated Value of x<sup>2</sup> = 19.6

Tabulated Value of  $\chi^2$  at 5% level of Significance for  $(R-1) \times (C-1)$  degree of freedom

$$= (2-1) \times (3-1) \text{ d.f.}$$

$$= 1 \times 2 \text{ d.f.}$$

$$= 2 \text{ d.f.}$$

$$= 5.991$$

$$\chi^2 \text{ Calculated} > \chi^2 \text{ Tabulated (i.e. } 19.6 > 5.991)$$

**Decision:**

Since the calculated value of Chi-Square is higher than the tabulated value of Chi-square at 5% level of significance for 2 degree of freedom. So, Null hypothesis is rejected in this level. i.e., alternative hypothesis is accepted, which means that the attitude of Investor's are affected by their occupation i.e., the businessman, student and retired person are less interested to purchase the government securities, because, they have enough time to seek the profitable stock and they can take the opportunity of the market. But the civil servant and the permanent employees of organized bodies haven't enough time. So they are more interested to purchase the government securities.

**Test – II**

It is said that the lower income group are more interested to purchase the government securities because they haven't available enough fund. So they do not want to invest their fund in risky stocks. So ever they are seeking for risk free securities but higher income group are always seeking the profitable stock to invest their fund. They will be ready to bear risk, because, they assume to bear risk as prestige on the society. So they are less interested to purchase the government securities. The randomly selected samples of people are classified according to their annual income. Here it is tested that the lower income group are more interested to purchase the government securities or not.

**Table No 4.3.3**

**4.3.2 Hypothesis Test for Investor Attitude on Government Securities in Terms of their Income Level**

Attitude	Investors With Annual Income			Total
	Equal to Rs	More than Rs.	More than or	
	50,000	50,000 but less than Rs. 3,00,000	Equal to Rs. 3,00,000	
More Interested	33	53	7	<b>93</b>
Less Interested	12	27	13	<b>52</b>
<b>Total</b>	<b>45</b>	<b>80</b>	<b>20</b>	<b>145</b>

**Formulation of Hypothesis:**

**Null Hypothesis (H<sub>0</sub>):** All income groups are equally interested to Purchase the government securities.

**Alternative hypothesis (H<sub>1</sub>):** The lower income groups are more interested to purchase the government securities.

**Fixing the Level of Significance:**

The level of significance ( $\alpha$ ) = 5%

**Calculation of Expected Frequencies:**

Expected Frequency of R<sub>1</sub>C<sub>1</sub> (33)

$$= \frac{\text{Row Total} \times \text{Column Total}}{\text{Grand Total}} = \frac{93 \times 45}{145} = 28.86$$

Expected Frequency of R<sub>2</sub>C<sub>1</sub> (12)

$$= \frac{\text{Row Total} \times \text{Column Total}}{\text{Grand Total}} = \frac{52 \times 45}{145} = 16.14$$

Expected Frequency of R<sub>1</sub>C<sub>2</sub> (53)

$$= \frac{\text{Row Total} \times \text{Column Total}}{\text{Grand Total}} = \frac{93 \times 80}{145} = 51.31$$

Expected Frequency of R<sub>2</sub>C<sub>2</sub> (27)

$$= \frac{\text{Row Total} \times \text{Column Total}}{\text{Grand Total}} = \frac{52 \times 80}{145} = 28.69$$

Expected Frequency of R<sub>1</sub>C<sub>3</sub> (7)

$$= \frac{\text{Row Total} \times \text{Column Total}}{\text{Grand Total}} = \frac{93 \times 20}{145} = 12.83$$

Expected Frequency of R<sub>2</sub>C<sub>3</sub> (13)

$$= \frac{\text{Row Total} \times \text{Column Total}}{\text{Grand Total}} = \frac{52 \times 20}{145} = 7.17$$

**Table No 4.3.4**

**Calculation of Chi-square ( $\chi^2$ )**

Observed Frequency	Expected Frequency (E)	(O-E)	(O-E) <sup>2</sup>	(O-E) <sup>2</sup> / E
33	28.86	4.14	17.14	0.59
12	16.14	-4.14	17.14	1.06
53	51.31	1.69	2.86	0.06
27	28.69	-1.69	2.86	0.10
7	12.83	-5.83	33.99	2.65
13	7.17	5.83	33.99	4.47
<b>Total</b>				<b>8.86</b>

**Test Statistics**

$$\text{Chi Square } (\chi^2) = \sum \frac{(O - E)^2}{E}$$

$$= 8.86$$

Calculated Value of  $\chi^2 = 8.86$

Tabulated Value of  $\chi^2$  at 5% level of Significance for (R-1) × (C-1) degree of freedom

$$= (2-1) \times (3-1) \text{ d.f.}$$

$$= 1 \times 2 \text{ d.f.}$$

$$= 2 \text{ d.f.}$$

= 5.991

$x^2$  Calculated >  $x^2$  Tabulated (i.e. 8.86 > 5.991)

**Decision:**

Since the calculated value of Chi-square is higher than the tabulated value of Chi-square at 5% level of significance for 2 degree of freedom. So, Null hypothesis is rejected in this level. i.e.; Alternative hypothesis is accepted, which means that the Lower income groups are more interested to purchase the government securities.

**Test – III**

It is said that the people who lives in the urban area are more aware towards the government securities because they get the information about the economic condition and the use of debt in time. They can also visit the several economic activities in the urban area, but the people who live in the rural areas are less aware towards the government securities because, they can't get information about the economic condition and use of the debt in time, and also they can't visit the economic activities in the rural area.

The randomly selected samples of people are classified according to their residence. Those people are taken as the people of rural area, who have been living at Kathmandu, from the rural area of Nepal. Here it is tested that the people of urban area are more aware towards the government securities than the people of rural areas or not.

**Table No 4.3.5**

**4.3.3 Hypothesis Test for Investor Attitude on Government Securities on the basis of Geographical Area**

Attitude	Investors		Total
	Rural Area	Urban Area	
More Aware	33	65	98
Less Aware	30	17	47
<b>Total</b>	<b>63</b>	<b>82</b>	<b>145</b>

**Formulation of Hypothesis:**

**Null Hypothesis (H<sub>0</sub>):** The people of both areas are equally aware towards the government securities.

**Alternative hypothesis (H<sub>1</sub>):** The people of urban area are more aware towards the government securities than the people of rural area.

**Fixing the Level of Significance:**

The level of significance ( $\alpha$ ) = 5%

**Calculation of Expected Frequencies:**

Expected Frequency of R<sub>1</sub>C<sub>1</sub> (33)

$$= \frac{\text{Row Total} \times \text{Column Total}}{\text{Grand Total}} = \frac{98 \times 63}{145} = 42.58$$

Expected Frequency of R<sub>2</sub>C<sub>1</sub> (30)

$$= \frac{\text{Row Total} \times \text{Column Total}}{\text{Grand Total}} = \frac{47 \times 63}{145} = 20.42$$

Expected Frequency of R<sub>1</sub>C<sub>2</sub> (65)

$$= \frac{\text{Row Total} \times \text{Column Total}}{\text{Grand Total}} = \frac{98 \times 82}{145} = 55.42$$

Expected Frequency of R<sub>2</sub>C<sub>2</sub> (17)

$$= \frac{\text{Row Total} \times \text{Column Total}}{\text{Grand Total}} = \frac{47 \times 82}{145} = 26.58$$

**Table No 4.3.6**

**Calculation of Chi-square ( $\chi^2$ )**

<b>Observed Frequency</b>	<b>Expected Frequency (E)</b>	<b>(O-E)</b>	<b>(O-E)<sup>2</sup></b>	<b>(O-E)<sup>2</sup> E</b>
33	42.58	-9.58	91.78	2.16
30	20.42	9.58	91.78	4.49
65	55.42	9.58	91.78	1.66
17	26.58	-9.58	91.78	3.45
<b>Total</b>				<b>11.76</b>

**Test Statistics**

$$\begin{aligned}\text{Chi Square } (\chi^2) &= \sum \frac{(O - E)^2}{E} \\ &= 11.76\end{aligned}$$

Calculated Value of  $\chi^2 = 11.76$

Tabulated Value of  $\chi^2$  at 5% level of Significance for (R-1)  $\times$  (C-1) degree of freedom

$$= (2-1) \times (2-1) \text{ d.f.}$$

$$= 1 \times 1 \text{ d.f.}$$

$$= 1 \text{ d.f.}$$

$$= 3.84$$

$\chi^2$  Calculated >  $\chi^2$  Tabulated (i.e.  $11.76 > 3.84$ )

**Decision:**

Since the calculated value of Chi-square is higher than the tabulated value of Chi-square at 5% level of significance for 1 degree of freedom. So, Null hypothesis is rejected in this level. i.e.; Alternative hypothesis is accepted, which means that the people of urban area are more aware towards the government securities than the people of rural area.

#### **Test – IV**

It is said that the awareness depends on the academic background of the people. That is, those people who came from the academic background of economics, finance, management and commerce are more aware than the people from other background, because this subjects are related to the securities where as other are not. The randomly selected samples of people are classified according to their academic background. The sample whose education level is up to S.L.C. is not included. Here it is tested that the people with academic background of economics, finance, management and commerce are more aware towards the government securities than the people of other academic background or not.

**Table No 4.3.7**

#### **4.3.4 Hypothesis Test for Investor Attitude on Government Securities in Terms of their Academic Backgrounds**

<b>Attitude</b>	<b>Academic Background</b>		<b>Total</b>
	<b>Economics, Finance, Management &amp; Commerce</b>	<b>Others</b>	
More Aware	80	28	<b>108</b>
Less Aware	14	23	<b>37</b>
<b>Total</b>	<b>94</b>	<b>51</b>	<b>145</b>

#### **Formulation of Hypothesis:**

**Null Hypothesis (H<sub>0</sub>):** The academic background and the awareness are not dependent each other.

**Alternative Hypothesis (H<sub>1</sub>):** The academic background and the awareness are dependent each other, i.e. the people whose academic background is Economics, Finance, Management & Commerce are more



aware towards the government securities than the people of others background.

**Fixing the Level of Significance:**

The level of significance ( $\alpha$ ) = 5%

**Calculation of Expected Frequencies:**

Expected Frequency of  $R_1C_1$  (80)

= Row Total  $\times$  Column Total =  $108 \times 94 = 70.01$

Grand Total 145

Expected Frequency of  $R_2C_1$  (14)

= Row Total  $\times$  Column Total =  $37 \times 94 = 23.99$

Grand Total 145

Expected Frequency of  $R_1C_2$  (28)

= Row Total  $\times$  Column Total =  $108 \times 51 = 38.99$

Grand Total 145

Expected Frequency of  $R_2C_2$  (23)

= Row Total  $\times$  Column Total =  $37 \times 51 = 13.01$

Grand Total 145

**Table No 4.3.8**

**Calculation of Chi-square ( $\chi^2$ )**

Observed Frequency	Expected Frequency (E)	(O-E)	(O-E) <sup>2</sup>	(O-E) <sup>2</sup> E
80	70.01	9.99	99.80	1.43
14	23.99	-9.99	99.80	4.16
28	37.99	-9.99	99.80	2.63
23	13.01	9.99	99.80	7.67
<b>Total</b>				<b>15.89</b>

### **Test Statistics**

$$\begin{aligned}\text{Chi Square } (x^2) &= \sum \frac{(O - E)^2}{E} \\ &= 15.89\end{aligned}$$

Calculated Value of  $x^2 = 15.89$

Tabulated Value of  $x^2$  at 5% level of Significance for  $(R-1) \times (C-1)$  degree of freedom

=  $(2-1) \times (2-1)$  d.f.

=  $1 \times 1$  d.f.

= 1 d.f.

= 3.84

$x^2$  Calculated >  $x^2$  Tabulated (i.e.  $15.89 > 3.84$ )

### **Decision:**

Since the calculated value of Chi-square is higher than the tabulated value of Chi-square at 5% level of significance for 1 degree of freedom. So, Null hypothesis is rejected in this level. i.e.; Alternative hypothesis is accepted, which means that the academic background and the awareness are dependent each other's i.e.; the people whose academic background is Economics, Finance, Management & Commerce are more aware towards the government securities than the people of others background.

## **4.3 THE SYSTEM AND PRACTICE OF GOVERNMENT SECURITIES IN NEPAL:**

### **4.3.1 Introduction:**

Government in every country works with the objective of improving the welfare of the people. Large percentage of people in the country has small income while some people in the country have high income. People with different income may be different opinion regarding the investment in various investment alternatives. Therefore, government need encourage

both low income people and high income people to invest in government bonds. There are Commercial Banks, Financial Institutions and other reputed private companies in the country that can be used for mobilization of small funds. People in the country invest their saving funds in different investment alternatives. Such investment should be used with the concept of utilization of small funds in the productive sectors.

If the person keeps money in the house, it is called idle funds. Such fund does not create earning. Therefore, it should be invested in the productive sectors. The person, who has traditional or conservative behavior, keeps money in the less risky investment as far as possible. They do not intend to bear risk so they search risk-less investment. The empirical test had been conducted in USA and it was found that the investors are risk averters. They prefer risk less investments.

Revenue generation is required for the better functioning of the government activities. But the collected revenues alone do not meet the requirements of government expenditure. Therefore, the government had to issue bonds to meet the deficit financing in the country. Government issues different types of internal debt to fulfill the different desire of the people. Most of the economists and financial analysts have focused that the internal debt does not create problem compared to external debt. The internal debt is the process of transferring fund from one person to another person. It helps for better implementation of monetary policy of the country. If country collects funds from external debt, the country's obligation will be high. In addition to this, the country has to follow their rules and regulations.

Securities can be classified either debt-type or ownership type. The government and private companies can issue debt securities. If the

securities are not traded in the secondary market, they are called non-marketable securities. Special Bonds issued by Nepal Rastra Bank (NRB) are such type of debt securities. Non-marketable securities are also common in economically advanced countries. Such securities contribute 30 percent to total public debt in United States. Government issues only debt securities and corporations issue debt as well as ownership securities, based on their capital structure. Holders of debt securities receive interest payment at predetermined rates and principal payment at the maturity of the debt instruments. Thus, periodic interest payment and capital gains are the incentives in bond instruments.

“Debt Securities market in Nepal is highly dominated by government debt securities. Corporate debt securities market in Nepal is extremely limited.” (Poudel 2059). Government in less developed countries usually borrow at lower rate than the market rate of interest on one hand on the other, such securities are exchanged in the face value even if their value has appreciated in the market.

**4.3.2 Pricing of Debt Securities:**

The values of bonds are determined by coupon rate and maturity period of debt securities. It is inversely related to the maturity period and the market rate of interest. The higher the coupon rate, the higher the value of the bond. The present value of the bond is calculated by summing all discounted coupons and principal payments with the discount rate being the market rate of interest of corresponding years as modeled below.

*(Samachar: NRB Annual Publication).*

$$\begin{aligned}
 B_0 = & \frac{C_1}{(1 + K_1)} + \frac{C_2}{(1 + K_1)(1 + K_2)} + \frac{C_2}{(1 + K_1)(1 + K_2)(1 + K_3)} + \dots \\
 & + \frac{C_N}{(1 + K_1)(1 + K_2)(1 + K_3)(1 + K_N)} + \frac{P}{(1 + K_1)(1 + K_2)(1 + K_3)(1 + K_N)}
 \end{aligned}$$

Where,  $B_0$  is the present value of the bond and  $P$ , the principal. Similarly  $K_1, K_2, K_3, K_N$  and  $C_1, C_2, C_3, C_N$  are market interest rates or going interest rates or discounted rates and coupon rates respectively. When market rate of interest goes down, the price of previously issued bonds at higher coupon rate goes up and investors receive capital gains.

Financial repression is a common phenomenon where economies are not liberalized. the government directed system is such repressed market fails to competitively determine interest rate on deposit and lending. While government borrows at rate lower than market rate of interest, the government coupon rates sometimes provide loan return on government debt security in negative at a time when the coupon rate is lower than inflation rate. Risk associated with bond investment reduces the value of the bond. The longer the period of maturity, the higher would be the default risk. Though, the default risk of government bonds is assumed zero, changes in inflation rate, tax rate, market rate of interest and depreciation of domestic currency affect the value of government bond. Thus, pricing of bonds is determined by the relevant macroeconomic variables as well.

## **Major Findings**

Government sells various securities to raise funds in the market. Such as Treasury Bills, National Saving Bonds, Development Bonds, citizen Saving Certificates, Special Bonds. These Securities are called government Securities. Government issues various types of securities both internally and externally. Government bond is an important source of public debt. Government issues various securities as per the appeal of investors. The internal investors of government are the people of the country. Government Securities are the normally less risky than others corporate securities. Therefore, the subscription of government issues does create serious problem in the market. In Nepal, the public debt was first raised in 1961 with the issue of Treasury bill. Thereafter the government has been issuing development Bond Special Debenture Bond, National Saving Bond and such other Securities to raise the fund internally and externally. The NRB which the Central Bank of Nepal issues various Government Securities on the behalf of Nepal Government. The Bank issues various Government Securities after analyzing the liquidation position of market, private investment opportunity, average interest rate in the market, inflation attitude of people toward risk bearing capacity, etc.

From the analysis of that following facts are found.

- ✓ The government has adopted a deficit budgetary system in the name of development functions. Treasury bills, development bonds, national saving bonds, citizen saving certificates and special bonds are the debt borrowing instrument in Nepal.
- ✓ The various securities are issues for the purpose of fulfilling varieties of problems of the country.
- ✓ Nepal has been suffering capital shortage since the first budget speech of Nepal. So it has been going through a critical phase of in

adequate financial resources, while its duties and responsibilities are widening day by day but the public funds available for the administration and development are limited. The government, therefore, adopts the policy of borrowing internally and externally.

- ✓ The government has been following liberal policy in the matter of collecting funds. The main objective from people. This increasing trend borrowing has created insignificant impacts on economy for future generation. It has led country to be considered as a levered country. Borrowing is good borrowed fund is used in productive sectors only.
- ✓ The enormously increasing magnitude of public debt is becoming a great challenge of the nation. The government had borrowed a total amount of Rs 9042.1 million in 1987 and the amount borrower reached to Rs. 85033 million in 2008. The government in 2005 has raised 9.40 times more debt than in 1987.
- ✓ Between the periods of 1987-2008, the average annual internal debt of total outstanding internal debt is 50,708.63 million.

#### **5.1.1 Finding through Questionnaire Survey and Test of Hypothesis.**

Survey and test of hypothesis following facts are found.

- ✓ The highest group of person in Nepal belonged to individual investors and the least of them are non investors.
- ✓ The Treasury Bills are highly subscribed in the market in the comparison to five government securities.
- ✓ The 55 percent respondents felt that they know about the government securities only a few years before. It justifies that government securities came into practice recently.
- ✓ The majority respondents (i.e. 51.63%) reported to know about government securities through papers and government notices and

the least of them came to know through other media like teachers, books.

- ✓ The majority investors 59.1 percent responded to invest government securities is a cause of tax free and collateral.
- ✓ A risk less feature is main reason for the investment in government securities. The majority investor in Nepal (i.e. 81.54%) felt this feature plays important role to invest in government securities.
- ✓ The government has been paying interest and principal regularly. A majority respondent felt no default risk. However, most of investors had grievances of interest and principal. They responded that there was a difficult of getting interest and principal due to behavior of the officials.
- ✓ The majority investors 62.48 percent sell government securities to grab alternative investment opportunities and the least of them sell to meet their household requirements and a cause of overpriced,
- ✓ The majority buyers are service holders on government securities and the least of them are retired people. However, the institutions are also considered as major investors.
- ✓ Large investors thought to invest idle cash in government securities and only few of them used loan in order to purchase the government securities.
- ✓ The majority respondents felt that lack of information of other investment sectors is main reason for the immediate subscription of government securities.
- ✓ The majority respondents felt the productive use of government borrowing but most of students are opposed and reported a misuse.
- ✓ By Chi-square test, it can be concluded that both educated and uneducated people are interested in government security. Thus, this



study draws the conclusion-'both poor and rich people are interested in government security'. But the income is the major factor of investment on government security. Anyway, the government is trying to draw the attention of rich and poor, educated and uneducated, businessman and service holders.

- ✓ The study on the other hand draws the result that the people in rural area are less aware to the government security. The study supports the general statement that the people in urban area are more aware about the government security. The study experimented the interest of various types of investors under their profession and carries the conclusion that the people who do not have sufficient time are interested to invest in government security. These people are normally semi-skilled to conduct private organization. Due to lack of good entrepreneurial skilled to conduct private organization. Due to lack of good entrepreneurial skills, they invest in government security for risk less investment.
- ✓ This study is concludes with the experiment of awareness of various categories of investors and drawn the result that persons with the academic background of economics and management are more aware to the government security.

## **CHAPTER-5**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Summary**

The government statement of income and expenditure was not in fixed schedule up to 1950's. The budget preparation was only for requirements certain class of the country. The budget was used to facilitate the requirement of such a class only. After restoration of democracy in 1951, the process of maintaining income and expenditure was set as per the house of democratic government. Thus, they were aimed at maintaining the statement of lives of the people rather than specific class. Accordingly, the government was completed to present a deficit budget. Till the 1960's decade, the deficit was met by bilateral grants.

Nepal started to raise the internal loans in fiscal year 1961/62 by issuing the treasury bills. People started to purchase government securities, as it constituted the risk less investment.

The government debt is neither worse nor it impairs the economy. The government has been borrowing funds people to maintain smooth and sound economic condition of the country. Government debt is issued to meet short-term and long-term financial requirement. The Government The government expenditure through public debt is quite beneficial to the nation if used productively. Thus, the government has been collecting huge amount of fund through sale of securities every year to fulfill the deficit budgetary system of Nepal.

The government of Nepal has been borrowing overdraft from NRB as well. The government must have paid the amount of overdraft with its interest to NRB within the stipulated period. This is why it is also considered as a kind of internal debt.

The debt financing of Nepal has also bad side as government has been borrowing according to its whim and it has pouring the borrowed fund into unproductive sectors. However, expenditure made on sectors likes health, education, road, bridge, irrigation; drinking water, etc have benefited Nepalese people. The nation as a whole gets positive returns such kinds of projects in the long run. The necessity to invest on such projects has been the main cause for deficit and hence public debt.

In fiscal year 2006, the total internal debt was Rs. 815091.3 million. The same debt was Rs. 9042.1 million in 1987. The debt raised by government has been increasing from the year 1987 to 2005. This may generate serious problems for future generations. The innocent children have to bear loan taken before their birth. Therefore, the increasing trend has to be managed soon. The country must have fair bureaucracy, sustainable economic growth, investment in productive sector, etc.

Government sells various securities to collect funds from people. Such as treasury bills, development bonds, national saving bonds, special bonds and citizen saving certificates. Treasury bills are issued every week. In 2006, the government has borrowed huge amount by issuing treasury bills. It is a short term government securities they are issued for 91 days maturity period. Others are long term securities they are issued to collect long term capital. But in case of special bonds, it has special provisions while issuing securities. Thus, government issues various types of securities both internally and externally. Many economists believe that borrowing internally is better than borrowing externally. The internal investors of the government are the people of the country.

It is obvious that the issuance of government bond is the cause of deficit budgetary system. Every year the finance minister presents the budget in

the parliament in which it is clearly mentioned the amount to be borrowed from various sectors. The Nepal Rastra Bank the Central Bank of Nepal issues various government securities on behalf of the government. The bank charges the government 0.25 percent commission on the transacted amount.

Borrowing provides an opportunity to get interest earning to those who have idle saving. Most economists agree that- 'borrowing is better than currency inflation'. On the other hand, most economists that borrowing today constitutes burden for future. A large public debt may create problem in the economy in future.

## **5.2 Conclusion**

The internal borrowing is the process of involving domestic people in the development programmed launched by the nation. This study shows that Nepalese investors are attracted to government securities in comparison to other investment sectors. Most of investors in Nepal are risk averter and they search less risky investment. Different people are participating in government securities such as, rich, poor, educated, uneducated, etc. This has supported general assumption that only required persons, civil servants are interested in government securities.

In response to collect sample, some investors responded some sorts of complaints and grievances against the marketability of security and its low interest rate than private investments. Government can rise from internally and externally. The analysts have focused that- 'the external loan creates the country in debt trap'. Internal loan is the process of transferring funds from one person to another person within country.

### **5.3 Recommendations**

On the basis of the analysis and findings of this study, following recommendations are suggested, which are required to be to solve the problem of debt finance economy of Nepal.

- The government should maintain the fiscal balance and strong fiscal and monetary discipline by controlling the unproductive expenditure so that budgetary expenses would not increase immensely than the annual revenue income government's effort should be directed towards mobilizing internal revenue in order to reduce dependency on loans for financing development expenditure.
- Since Nepal is still backward in terms of developmental infrastructure, there is no alternative except from external source to industrialize the nation. Besides, the capital is need of formulating the long term plan for export promotion and coordinating the various export related activities such as product development, market promotion all over the various functions in the country. Therefore, the government should develop various methods to influence the business and private individuals to buy more and more government securities.
- The government should maintain the strong fiscal discipline in all sectors of the economy which government itself must follow initially. The government must set and implement the effective legal system to control the ever-increasing corruption, unnecessary expenses, improper allocation of resources and the like. Likewise the suggestions by auditor general office must be adopted instantly. Thus, maximum effort should be exercised to maintain the fiscal discipline so that budgetary deficit would be minimized without impairing existing development programs.

- Borrowing from banking sectors must be minimized since it is most inflationary source of internal borrowing. The government should influence individuals to use their idle money on government security because this stimulates the investment. At the sometime this sort of borrowing is non inflationary.
- The most common problem of undeveloped countries like Nepal is the loose monitoring and inspection of the progress of newly launched projects. Regular reviewing must be made on the return of the projects so that they help improve the rate of future projects.
- The government should not unnecessary interface NRB. If so, the bank, being an advisor of the government can be recommended the salutary measures independently which help the government to tackle the fiscal and monetary problem in the nation.
- The government may borrow the overdraft from NRB with the stipulated limitation but the bank should not be completed to provide the overdraft as per the government's adhoc decision.
- To attract people towards government security it is essential that some special bonds might be issued for development work for a particular locality. When such development work as bridge, road, irrigation, communication, etc. would be built with the funds from the special bonds at a place, people of the other localities might be encouraged to purchase such bonds. On the other hand, NRB should strongly direct all the commercial banks that they must pay the interest of the government's bond of their respective customers timely and claim the amount with NRB afterwards. It is because a few government payment at some of commercial banks in Nepal , thought investors are provided the facility that they can collect their interest from any commercial banks in Nepal.
- The debt management to control and regulate the economic activity is an instrument in the hands of the monetary authorities like ministry of finance and Nepal Rastra Bank in the nation. All the

decisions regarding the public debt from borrowing to redemption of loan influence the general economic phenomena in country. All possible efforts therefore, are needed to be made by the monetary authorities to direct economy in the desired way through the technique of debt management.

- Along with the strong fiscal discipline the government should finance the public borrowing on productive programs, which can provide the return most efficiently as short. If this can be done the national revenue will increase faster and inevitably that debt-servicing ability will also increase in the same pace. And the question of debt trap won't at all.

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### **Appendix (Questionnaire)**

I would like to kindly request to all respective respondents to give their view on under mentioned questionnaire on the basis of answer/options available for the research purpose. The information provided by the Respondent will be kept strictly confidential and will be used only for analysis of group behaviors.

Full Name:	
Profession:	
Age:	Sex:

1. In which profession on you are involved at present?

- Businessman
- Service holder
- Retired person
- Other (specify) .....

2. In which of the following monthly income group you belong?

- Below Rs. 10000
- Rs 10000 to 20000
- Rs. 20000 to Rs. 40000
- Above Rs. 40000

3. In what following classes you want to put yourself?

- Highly interested to buy government securities
- Moderate interested to buy government securities
- Less interested to buy government securities
- Totally indifferent to buy government securities



4. In your opinion, what types of Government Securities are highly subscribed in the market? (Mark 1, 2,3,4,5, in order of priority)

Treasury Bills

Development Bonds

National Saving Bonds

Special Bonds

Citizen Saving Certificate

5. What is the main reason for investment in Government Securities?  
Risk-less investment

- Zero liquidity risk
- Lack of other investment opportunity
- Declining interest rate in other investment sectors (i.e. interest rate on saving account)

6. Have you felt any difficulty in collecting interest and principal of your investment?

- Difficult due to long process
- Difficult due to complex procedures
- No difficulty at all
- Others (specify).....

7. Which of the following makes one to sell the Government Securities?

- To grab alternative investment opportunity (i.e. to invest on shares issued by the reputed private company)
- To meet household requirement
- To benefit from investment in real estate (tangible assets)
- When stock is overpriced
- Others specify).....

8. In your opinion, why general investors are low participating in investment of Government Securities?

- Lower annual rate of return
- Complex rules and regulation to be followed at the time of making investment.
- No consideration of time value of money.
- Others (specify).....

9. What kinds of fund do you use to purchase Government Securities?

- Residual amount
- Profit from business
- Loan
- Retirement fund
- Others (specify).....

9. Mark (1,2,3,4) in order to priority the reasons for full subscription of Government Securities?

- High Marketability
- Convenient to purchase and sell
- Involve low risk.
- Lack of information of other investment sector
- Others (specify).....

10. What is your opinion about the utilization of collected fund from the people?

- It will be utilized properly
- It will be unutilized
- Can not say
- Others (specify).....